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Supreme Court, U.S.
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In The

Supreme Court of the United States

GEOFFREY, INC.,

Petitioner,

v.

COMMISSIONER OF REVENUE,

Respondent.

On Petition For A Writ Of Certiorari To The Supreme Judicial Court Of Massachusetts

PETITION FOR A WRIT OF *CERTIORARI*

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QUESTION PRESENTED

Whether the decision of the Supreme Judicial Court of Massachusetts, in conflict with the decisions of other state courts and the precedent of this Court, violates the Commerce Clause by permitting a State to tax the income of an out-of-state corporation that does not maintain a physical presence in the taxing State.

PARTIES TO THE PROCEEDING

The parties are as stated in the caption.

RULE 29.6 CORPORATE DISCLOSURE STATEMENT

For the years at issue in this dispute (the fiscal years ending January 31, 1997 through January 31, 2001), petitioner Geoffrey, Inc. was wholly owned by TRU, Inc., which is a wholly owned subsidiary of Toys "R" Us, Inc.

In 2008, Geoffrey, Inc. was converted into a single member limited liability company. Geoffrey, LLC currently is a wholly owned subsidiary of Geoffrey Holdings, LLC. Geoffrey Holdings, LLC is a wholly owned subsidiary of Toys "R" Us-Delaware, Inc. Toys "R" Us-Delaware, Inc. is a wholly owned subsidiary of Toys "R" Us, Inc.

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PETITION FOR A WRIT OF *CERTIORARI*

Petitioner Geoffrey, Inc. respectfully petitions for a writ of *certiorari* to review the judgment of the Supreme Judicial Court of Massachusetts.

OPINIONS BELOW

The opinion of the Supreme Judicial Court for the Commonwealth of Massachusetts (App., *infra*, 1a-18a) is reported at 453 Mass. 17 (2009). The appeal was transferred from the Appeals Court by order (App., *infra*, 19a-20a) granting application for direct review. The decision, findings of fact, and report of the Massachusetts Appellate Tax Board (App., *infra*, 21a-46a), are unreported.

JURISDICTION

The Supreme Judicial Court of Massachusetts entered its judgment on January 8, 2009.

This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

CONSTITUTIONAL, STATUTORY, AND REGULATORY PROVISIONS INVOLVED

Article I, Section 8, clause 3 of the United States Constitution provides: "The Congress shall have Power * * * [t]o regulate Commerce * * * among the several States * * *."

The relevant portions of the Massachusetts general laws and regulations are set forth at App., *infra*, 47a-124a.

INTRODUCTION

The question presented involves one of the most significant constitutional state tax issues currently being litigated in the state courts. It is an issue of great magnitude that has hopelessly divided state courts around the Nation, and it is worth billions of dollars annually to thousands of businesses worldwide, both large and small—from owners of intellectual property such as petitioner, to credit card companies, to authors earning royalties, to music publishers, to software companies, and to many more.

In these challenging financial times, States are mired in red ink and are, with alarming frequency, dramatically expanding their tax base without regard to constitutional limitations, in order to extract tax revenues from out-of-state corporations that do not have even the slimmest of reeds connecting them to the taxing State. Oftentimes, this tax revenue falls within the jurisdiction of another State. In the ruling below, Massachusetts has become the latest State to impose income-based taxes on out-of-state corporations even when they do not maintain a physical presence in the taxing State.

In order to uphold application of the Massachusetts tax against out-of-state corporations

without a physical in-state presence, the Massachusetts Supreme Judicial Court had to distinguish *Quill Corp. v. North Dakota,* 504 U.S. 298 (1992), and hold that the prohibition of *Quill* against state taxation on out-of-state corporations unless they have an in-state physical presence applies only to sales and use tax collection, *i.e.*, taxes on buyers that are collected by the out-of-state corporation and remitted to the State. The Massachusetts court concluded that, notwithstanding *Quill*, Massachusetts may tax the income of an out-of-state corporation such as petitioner Geoffrey even though Geoffrey does not maintain a physical presence in the Commonwealth of Massachusetts, because the tax is based on royalties that Geoffrey receives from the use by others in Massachusetts of Geoffrey's intellectual property. This ruling by the Massachusetts court relied on the rationale set forth in its decision rendered the same day in *Capital One Bank v. Commissioner of Revenue*, 899 N.E.2d 76 (Mass. 2009), *petition for cert. filed*, (U.S. Mar. 18, 2009) (No. 08-1169), where the court upheld the validity of applying Massachusetts' financial institutions excise tax to out-of-state credit card businesses that similarly do not maintain any physical presence in Massachusetts, but receive income from in-state credit card customers. The state court adopted an "elastic" nexus test that allows State taxation of an out-of-state corporation when the out-of-state corporation receives income from an in-state entity. App., *infra*, 3a.

The ruling of the Massachusetts' court cannot be reconciled with *Quill*, where this Court reaffirmed the longstanding constitutional requirement in *National Bellas Hess, Inc. v. Department of Revenue of Illinois*, 386 U.S. 753 (1967), that the substantial nexus between a taxing State and an out-of-state corporation being taxed, which is required to satisfy the Commerce Clause, can be met only if the out-of-state corporation has a physical presence in the taxing State. Moreover, irrespective of whether this Court believes the instant dispute is governed by *Quill* and *Bellas Hess*, this significant constitutional question should not remain unanswered by this Court.

The recent twin rulings in this case and *Capital One* by the Supreme Judicial Court of Massachusetts join a growing list of state appellate court decisions that have reached divergent conclusions on this issue, in numerous contexts, because of the lack of a decision from this Court. Thus far, approximately *one-third* of all the States in the Nation, 16 in total, have examined *Quill* and *Bellas Hess* and have come to their own view of the federal constitutional question. Three of those States—Tennessee, Michigan, and Texas—have concluded (correctly, in our view) that a taxing State may not, consistent with the Commerce Clause, impose on an out-of-state corporation the State's income or franchise taxes—*i.e.*, direct taxes on the corporation—unless the out-of-state corporation maintains a physical presence in the taxing State. And the appellate courts of 13 other States—Illinois, Louisiana, Maryland, New Jersey,

New Mexico, North Carolina, Ohio, Oklahoma, South Carolina, Washington, West Virginia, Wyoming and now Massachusetts—have come to a different conclusion. Those courts have held that the constitutionally required substantial nexus between the taxing State and the out-of-state corporation can be satisfied by a mere and amorphous economic connection to the taxing jurisdiction, without any in-state physical presence.[1]

Regardless of which side of the dispute is correct, it is now clear that this entrenched conflict in the state courts will not resolve itself absent this Court's intervention. No state court we cite that has decided this issue, one way or the other, has revisited the question presented and switched sides in the dispute.

Moreover, Congress has given no indication in the nearly two decades since *Quill* was decided, that it intends to follow up on this Court's suggestion in *Quill* that this is a question "that Congress may be better qualified to resolve." *Quill*, 504 U.S. at 318.

Accordingly, corporations that engage in interstate commerce involving numerous States in which they do not maintain a physical presence are left with an intolerable patchwork of inconsistent state laws concerning the scope of state tax jurisdiction under the Commerce Clause. And state taxing authorities in

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[1] In addition, many administrative, trial and tax court decisions on the question have been issued by other States, some of which are still subject to appellate review.

different States currently are bound by different interpretations of the federal constitutional limitations on state taxation of out-of-state corporations. This should not be the case, particularly for an issue as important as this. This constitutional question is worth billions of dollars annually. And absent this Court review, the state courts will continue to inconsistently decide who—the out-of-state corporation such as petitioner or the state taxing authority—is entitled to this money.

There is no reason for this Court to defer resolution of this conflict in the state courts. No better vehicles will present themselves than the twin rulings of the Supreme Judicial Court of Massachusetts in the instant case and the *Capital One* case. They provide this Court the opportunity to rule on the scope of the federal constitutional limitation on state taxation of the income of an out-of-state corporation in the context of different industries and different underlying factual scenarios. The petition for a writ of *certiorari* should be granted.

STATEMENT OF THE CASE

A. Constitutional, Statutory, And Regulatory Framework

1. More than forty years ago, this Court in *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967), confirmed the longstanding Commerce Clause doctrine that a State imposes an unconstitutional burden on interstate commerce

when it imposes tax collection and remittance responsibilities on an out-of-state corporation that lacks any physical presence in the taxing State. The *Bellas Hess* Court canvassed Supreme Court precedent back to 1939, and concluded that there is a "sharp distinction" between "sellers with retail outlets, solicitors, or property within a State, and those who do no more than communicate with customers in the State by mail or common carrier." *Bellas Hess*, 386 U.S. at 758. The Court explained that that distinction, which was the basis for those entities within the State being subject to State taxation and those outside of the State not being taxed, had "been generally recognized by the state taxing authorities," and "is a valid one." *Ibid.* The Court therefore "decline[d] to obliterate it." *Ibid.*

A decade after *Bellas Hess*, the Court set forth a general test for dormant Commerce Clause challenges to the exercise of state taxing power in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977). Under *Complete Auto*, a state tax will be upheld against a Commerce Clause challenge if the state tax: (1) "is applied to an activity with a substantial nexus with the taxing State"; (2) "is fairly apportioned"; (3) "does not discriminate against interstate commerce"; and (4) "is fairly related to the services provided by the State." *Id.* at 279.

In the years that followed *Complete Auto*, a number of state courts concluded that the "substantial nexus" requirement of *Complete Auto* had replaced the need under *Bellas Hess* for an

out-of-state corporation to have a physical presence in the taxing State in order for the state tax to be constitutionally applied. But this Court rejected that argument in *Quill Corporation v. North Dakota*. In *Quill*, the Court addressed again the Commerce Clause issue in a case involving the imposition on an out-of-state corporation of a use tax—*i.e.*, a tax effectively levied on the buyer but collected by the seller and remitted to the State. The *Quill* Court reaffirmed the central holding of *Bellas Hess* and ruled that the *Complete Auto* requirement that there be a "substantial nexus" between the taxing State and an out-of-state corporation can be met only where the corporation maintains a "physical presence" in the taxing State. *Quill Corp. v. North Dakota*, 504 U.S. 298, 314 (1992).

These rulings by the Court reflect core principles that undergird the Constitution, and which are reflected in the Commerce Clause, that a State may not regulate beyond its geographic borders into the boundaries of its sister States. As this Court has explained, "[i]n a Union of 50 States, to permit each State to tax activities outside its borders would have drastic consequences for the national economy, as businesses could be subjected to severe multiple taxation." *Allied-Signal, Inc. v. Director, Div. of Taxation*, 504 U.S. 768, 777-778 (1992).

2. Respondent Massachusetts broadly taxes out-of-state corporations on income they derive from the in-state use by others of the out-of-state corporation's intangible property. And Massachusetts

does so regardless of whether the out-of-state corporation maintains a physical presence in Massachusetts.

The statutes of Massachusetts provide that "every foreign corporation, exercising its charter, or qualified to do business or actually doing business in the commonwealth, or owning or using any part or all of its capital, plant or any other property in the commonwealth, shall pay, on account of each taxable year" an excise tax. Mass. Gen. Laws ch. 63, § 39, 39(3)(a)(2), 39(3)(b). The stated purpose of that tax is "to require the payment of this excise to the commonwealth by foreign corporations for the enjoyment under the protection of the laws of the commonwealth, of the powers, rights, privileges and immunities derived by reason of the corporate form of existence and operation." *Id.* § 39(3).

Section 38(f) of the Massachusetts General Laws sets forth the rules for apportioning sales to Massachusetts in computing "net income determined to be taxable in accordance with the provisions of this chapter." That provision states that a sale is attributed to Massachusetts if it is derived from a sale "other than sales of tangible personal property" that occurs in Massachusetts "if 1. the income-producing activity is performed in this commonwealth; or 2. the income-producing activity is performed both in and outside this commonwealth and a greater portion of this income-producing activity is performed in this commonwealth than in

any other state, based on costs of performance." *Id.* § 38(f).

The Massachusetts Department of Revenue has promulgated regulations construing Section 38(f) that permit the apportionment to the State of the income received by an out-of-state corporation from its licensing of intangible property, such as trademarks, for use by licensees and rests on where and how much the licensee uses the property:

> Gross receipts from the licensing of intangible property are attributable to Massachusetts if the property is used by the licensee solely in Massachusetts. If the licensee uses the intangible property in more than one state, the gross receipts from the licensing are attributable to Massachusetts if the use of property by the licensee in Massachusetts exceeds its use of the property in any other one state.

830 Mass. Code Regs. § 63.38.1(9)(d)(3)(c) (2001).

The Massachusetts Department of Revenue has issued a directive addressing when use of intangible property by another in the State can subject to state taxation an out-of-state corporation who licensed the property. Directive 96-2 provides:

> A foreign corporation's intangible property used within Massachusetts will subject that corporation to corporate excise when:
>
> 1. The intangible property generates, or is otherwise a source of, gross receipts within

> the state for the corporation, including through a license or franchise; and
>
> 2. The activity through which the corporation obtains such gross receipts from its intangible property is purposeful (e.g., a contract with an in-state company); and
>
> 3. The corporation's presence within the state, as indicated by its intangible property and its activities with respect to that property, is more than de minimus.

Mass. Dep't of Revenue Directive 96-2.

B. Factual Background[2]

1. Petitioner Geoffrey, Inc. was a Delaware corporation formed in 1984 as a wholly-owned subsidiary of Toys "R" Us, Inc. Petitioner owned intellectual property in the form of trademarks, tradenames and service marks which it licensed to third parties and other legal entities, including to Toys "R" Us-Mass, Inc. (TRUMI) and Baby Superstore, Inc.

TRUMI operated Toys "R" Us retail toy stores and Kids "R" Us retail children's clothing stores in Massachusetts during the fiscal years at issue. App.,

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[2] The facts recited in this Petition are taken primarily from the stipulated factual record; no material facts in this case were in dispute. Unless stated to the contrary, the facts relate to the tax years at issue, which are Geoffrey's fiscal years that ended January 31, 1997 through January 31, 2001.

infra, 26a. Baby Superstore, Inc., beginning with the fiscal year ended January 31, 1998, operated Babies "R" Us retail stores throughout the country, including three in Massachusetts, through its Babies "R" Us division. App., *infra*, 28a. Neither TRUMI nor Baby Superstore, Inc., are parties in the instant matter.

2. Respondent did not dispute that petitioner was formed for valid business purposes and had economic substance. Petitioner had no physical presence in Massachusetts. Petitioner does not own or maintain any offices, employees, or real or tangible personal property in Massachusetts. App., *infra*, 28a.

Petitioner's business activities were carried out through its board of directors which met annually outside of Massachusetts, and by support services performed in New Jersey, not Massachusetts, by Toys "R" Us for which petitioner paid arm's length rates,[3]

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[3] Respondent does not dispute that the payments made between the related companies, including royalties, were at arm's length rates. An independent tax tribunal held that the license between Geoffrey and another one of its licensees was at arm's length rates. *In re Toys "R" Us-NYTEX, Inc.*, No. TAT(E) 93-1039 (GC), 2004 N.Y. City Tax LEXIS 11 (N.Y.C. Tax App. Trib., Jan. 14, 2004), *aff'g*, No. TAT(H) 93-1039 (GC), 1999 N.Y. City Tax LEXIS 31 (N.Y.C. Tax App. Trib., Aug. 4, 1999). Further, in that case, the administrative law judge concluded that: "Geoffrey was created for several valid business purposes, including but not limited to owning and protecting the existing Toys 'R' Us trademarks and trade names; establishing and registering new trademarks and trade names; licensing those trademarks and trade names to both related and unrelated entities; and defending the integrity of the trademarks in

(Continued on following page)

and with the advice of New York-based trademark counsel. App., *infra*, 26a-28a. The license agreement between petitioner and TRUMI was executed outside of Massachusetts and during the years at issue petitioner did not use any state or federal courts in Massachusetts. App., *infra*, 27a-28a, 8a n.7.

3. TRUMI and Baby Superstore, Inc., conducted business in Massachusetts and filed Massachusetts corporation excise tax returns. Both TRUMI and Baby Superstore, Inc., claimed deductions for the royalties paid to Geoffrey.

Based on its audit of TRUMI, respondent began a nexus investigation of petitioner. On January 28, 2003, relying on its Directive 96-2, which provides that an out-of-state corporation is subject to Massachusetts' corporate excise tax in almost any circumstance where the out-of-state corporation's intangible property is used by another in Massachusetts with profit-seeking intent, respondent issued a Notice of Assessment against petitioner which, as revised by stipulation, imposes a tax of $1,257,793 with interest of $567,101. App., *infra*, 24a, 7a n.6. The notice also imposed late filing, late

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litigation with third parties. Geoffrey paid its own expenses, including fees to unrelated law firms and accounting firms. The credible testimony and evidence demonstrate not only that it was anticipated that Geoffrey would realize a profit from its licensing activities, apart from any tax benefit, but that in fact Geoffrey did realize such a profit." 1999 N.Y. City Tax LEXIS 31.

payment, and underpayment penalties of an additional $631,541. App., *infra*, 7a n.6.

C. Proceedings Below

1. Petitioner sought review of the assessment to the Massachusetts Appellate Tax Board, which rejected the appeal. The Tax Board concluded that Geoffrey's reading of *Quill* was too "broad" and that "neither * * * Supreme Court nor Massachusetts precedent supports the proposition that physical presence is required to impose an income-based tax." App., *infra*, 40a (citation omitted).

2. Petitioner filed an appeal with the Massachusetts Appeals Court and an application for direct appellate review with the Supreme Judicial Court of Massachusetts. App., *infra*, 1a. The Supreme Judicial Court granted the application and transferred the case to its jurisdiction. App., *infra*, 19a-20a. The court also granted a direct application for review in *Capital One Bank v. Commissioner of Revenue*, 899 N.E.2d 76 (Mass. 2009), *petition for cert. filed*, (U.S. Mar. 18, 2009) (No. 08-1169), to address the same question of whether the State's imposition of the financial institution excise tax on out-of-state corporations is constitutionally limited to those corporations that maintain a physical presence in the State and, therefore, meet the constitutional nexus requirement. Both the instant case and the *Capital One* case were argued before the Supreme Judicial Court on October 7, 2008.

3. The Massachusetts Supreme Judicial Court affirmed the Tax Board in both cases.

In the instant case, the court relied heavily on its ruling issued the same day in *Capital One*. The court held that "substantial nexus can be established where a taxpayer domiciled in one State carries on business in another State through the licensing of its intangible property that generates income for the taxpayer." App., *infra*, 11a. The court explained it was "join[ing] other jurisdictions that have considered the physical presence issue in the context of intangible property and have upheld the imposition of income-based tax assessments." *Ibid.* Even though the court acknowledged that the licenses with TRUMI and Baby Superstore, Inc., "permitted *those* entities to use the trademarks exclusively in Massachusetts," the court suggested that the licensee's activities were attributable to petitioner due to (1) the purported "encourage[ment to] Massachusetts customers to shop at Toys 'R' Us, Kids 'R' Us, and Babies 'R' Us through an *implicit* promise, manifested by the trademarks, that the products at those stores would be of good quality and value"; (2) petitioner's purported reliance on employees of TRUMI to "maintain a positive retail environment"; and (3) petitioner's quality control of licensed products to "maintain its positive reputation with Massachusetts customers." App., *infra*, 13a (emphasis added). But the court's conclusion that petitioner had a substantial nexus to Massachusetts due to its alleged "business activities" which resulted in "substantial

profits," was based at bottom on petitioner's out-of-state licensing of intangible property that generated income related to their use by the licensees in Massachusetts.

REASONS FOR GRANTING THE PETITION

REVIEW IS NECESSARY BECAUSE THE STATES ARE HOPELESSLY DIVIDED OVER WHETHER A STATE CAN TAX THE INCOME OF AN OUT-OF-STATE CORPORATION THAT DOES NOT MAINTAIN A PHYSICAL PRESENCE IN THE TAXING STATE

A. Sixteen State Courts Have Weighed In On The Conflict Regarding Whether This Court's Longstanding Requirement Of *Bellas Hess* And *Quill*, That A State May Tax An Out-Of-State Corporation Only If The Corporation Maintains A Physical Presence In The Taxing State, Applies To Income Taxes

There is a mature, well-recognized, and entrenched split of authority among the state courts on the question of whether the Commerce Clause prohibits the imposition by a State of income taxes on an out-of-state corporation that does not maintain any physical presence in the taxing State.

1. The decision below conflicts directly with the state appellate court rulings in Tennessee, Michigan and Texas.

The Tennessee court in *J.C. Penney National Bank v. Johnson*, held that Tennessee could not tax

the corporate earnings of out-of-state corporations that had no physical presence in Tennessee. The court explained that no valid distinction could be made for Commerce Clause purposes between such an income-based tax and the sales and use taxes at issue in *Bellas Hess* and *Quill*. The Tennessee court thus held that, "[w]hile it is true that the *Bellas Hess* and *Quill* decisions focused on use taxes, we find no basis for concluding that the analysis should be different in the present case." *J.C. Penney Nat'l Bank v. Johnson*, 19 S.W.3d 831, 839 (Tenn. Ct. App. 1999), *cert. denied*, 531 U.S. 927 (2000).

The Michigan court, in *Guardian Industries Corp. v. Department of Treasury*, 499 N.W.2d 349 (Mich. Ct. App. 1993), likewise stated, in a case involving a single business tax, that "after *Quill*, it is abundantly clear that" there must be "a physical presence within a target state to establish a substantial nexus to it." *Id.* at 377.

The Texas court, in *Rylander v. Bandag Licensing Corp.*, 18 S.W.3d 296 (Tex. Ct. App. 2000), adhered to *Quill*'s reasoning, and held that Texas cannot impose on an out-of-state corporation, that does not maintain a physical presence in the State, the State's franchise tax, *i.e.*, a tax on the privilege of doing business in the State. The Texas court explained that, "[w]hile the decisions in *Quill Corp.* and *Bellas Hess* involved sales and use taxes, we see no principled distinction when the basic issue remains whether the state can tax the corporation at all under the Commerce Clause." *Id.* at 300. The Texas court held that, where a "corporation conducts its activity solely through

interstate commerce and lacks any physical presence in the state, no sufficient nexus exists to permit the state to assess tax." *Ibid.*

2. On the other side of the legal divide, the Supreme Judicial Court of Massachusetts has joined the appellate courts of Illinois, Louisiana, Maryland, New Jersey, New Mexico, North Carolina, Ohio, Oklahoma, South Carolina, Washington, West Virginia, and Wyoming in holding that States may impose income and franchise taxes on an out-of-state corporation even though the corporation does not maintain any physical presence in the State. Most of these courts have acknowledged that their decisions depart from the precedent in other States.

The New Jersey Supreme Court recently declared that "[s]ince the Court decided *Quill*, a split of authority has developed regarding whether the Supreme Court's holding was limited to sales and use taxes." *Lanco, Inc. v. Director, Div. of Taxation*, 908 A.2d 176, 177 (N.J. 2006), *cert. denied*, 127 S. Ct. 2974 (2007). The New Jersey court then concluded, erroneously in our view, that "the better interpretation of *Quill* is the one adopted by those states that limit the Supreme Court's holding to sales and use taxes." *Ibid.*

A divided West Virginia Supreme Court immediately followed the New Jersey court's *Lanco* ruling in *Tax Commissioner v. MBNA America Bank, N.A.*, 640 S.E.2d 226 (W. Va. 2006). The West Virginia court also acknowledged the disagreement among the

state courts as to whether the physical presence requirement articulated in *Quill* applies to income and franchise taxes, and that that issue was a "major question left open by the Supreme Court's opinion." *Id.* at 231. In "reject[ing]" the Tennessee *J.C. Penney* court's reasoning requiring an out-of-state corporation to have a physical presence in the taxing State, the West Virginia court held that the "significant economic presence test is a better indicator of whether substantial nexus exists for Commerce Clause purposes." *Id.* at 234.[4]

Several other state appellate courts similarly acknowledge the conflict among the courts in express terms. *See Bridges v. Geoffrey, Inc.*, 984 So.2d 115, 127 (La. Ct. App. 2008) (rejecting *Quill*'s physical presence requirement and describing the decisions of the Tennessee and Texas cases as not "persuasive"); *Geoffrey, Inc. v. Oklahoma Tax Comm'n*, 132 P.3d 632 (Okla. Ct. App. 2005) (rejecting *Quill*'s physical presence requirement and attempting to distinguish the Tennessee and Texas decisions); *A&F Trademark, Inc. v. Tolson*, 605 S.E.2d 187, 196 n.9 (N.C. Ct. App. 2004) (rejecting *Quill*'s physical presence requirement for income taxation and attempting to distinguish the

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[4] This conclusion by the West Virginia court was strongly disputed by the dissent. The dissent emphasized that "[t]he jurisprudential reality is that the United States Supreme Court has never held in any state tax case that the nexus requirements of the Commerce Clause can be satisfied in the absence of a taxpayer's physical presence in the taxing state." *Id.* at 239 (Benjamin, J., dissenting).

Tennessee court's *J.C. Penney* decision); *General Motors Corp. v. City of Seattle*, 25 P.3d 1022, 1028 (Wash. Ct. App. 2001) (rejecting *Quill*'s physical presence requirement and noting that the taxpayers "correctly argue that some state courts have extended the physical presence rule").

In addition, a number of other state courts have held, without explicitly recognizing the conflict, that "the taxpayer need not have a tangible, physical presence in a state for income to be taxable there." *Geoffrey, Inc. v. South Carolina Tax Comm'n*, 437 S.E.2d 13, 18 (S.C. 1993); *see also Couchot v. State Lottery Comm'n*, 659 N.E.2d 1225, 1230 (Ohio 1996) ("There is no indication in *Quill* that the Supreme Court will extend the physical-presence requirement to cases involving taxation measured by income derived from the state."); *Buehner Block Co. v. Wyoming Dep't of Revenue*, 139 P.3d 1150, 1158 n.6 (Wyo. 2006) (noting that "*Bellas Hess* and *Quill* * * * created [a] specialized jurisprudence" applicable to "sales or use tax case[s]"); *Kmart Props., Inc. v. Taxation & Revenue Dep't*, 131 P.3d 27, 35 (N.M. Ct. App. 2001), *writ quashed*, 131 P.3d 22, 35-36 (N.M. 2005) (same); *Comptroller of the Treasury v. Syl, Inc.*, 825 A.2d 399, 415-416 (Md. 2003) (same); *Borden Chems. & Plastics, L.P. v. Zehnder*, 726 N.E.2d 73, 80-81 (Ill. Ct. App. 2000) (same).

3. The fact that the Tennessee, Michigan, and Texas decisions do not come from state courts of last resort does not, in any way, lessen the adverse

consequences of the conflict in the state courts and does not undermine the need for review by this Court.

As a matter of state procedural law, the Tennessee Supreme Court's denial of further review in *J.C. Penney* approved and adopted the reasoning of the state appellate court when it denied review. *See State v. Cawood*, 134 S.W.3d 159, 164 n.6 (Tenn. 2004) (when the Tennessee Supreme Court "denies a writ of *certiorari*, the Court takes jurisdiction and makes a final disposition of the case by approving the final decree of the intermediate court").

Likewise, under state procedural law, the Michigan appellate decision is binding precedent throughout that State. *See Tebo v. Havlik*, 343 N.W.2d 181, 185 (Mich. 2004). In addition, the Michigan Department of Revenue has announced that it will adhere to the physical presence requirement in light of the *Guardian Industries* decision, *see J.W. Hobbs Corp. v. Revenue Div., Dep't of Treasury*, 706 N.W.2d 460, 463 (Mich. App. 2005).

Finally, Texas appellate procedure requires that Texas courts treat as binding precedent a decision such as the *Rylander* imposing the physical presence requirement. *See Messina v. State*, 904 S.W.2d 178, 181 (Tex. App. 1995).

Moreover, even if any of these decisions were subject to reconsideration by their own state courts, it is clear from the years that have passed from the dates of these rulings that these decisions are

entrenched. Not one of these state courts has revisited its prior conclusion.

B. The Decisions Of The Massachusetts Supreme Judicial Court Here And In *Capital One* Cannot Be Reconciled With This Court's Commerce Clause Precedent

Although the sheer breadth of the disagreement in the state courts alone should compel this Court to grant *certiorari* in the instant case, the petition also should be granted because the decision below cannot be reconciled with the Court's precedent.

1. This Court's Commerce Clause Holdings In *Quill* And *Bellas Hess* Govern This Case Because They Do Not Distinguish Between Different Types Of State Tax

a. Review is necessary here because, in attempting to avoid *Quill* and *Bellas Hess*, the court below and numerous other state courts have opined that this Court, and thus the Constitution, somehow distinguishes between sales and use taxes on the one hand and income and franchise taxes on the other. App., *infra*, 17a, 40a, 43a. But this Court's precedent does not support such a distinction because this Court has reasoned that the requirement under the Commerce Clause for a "substantial nexus" between a State and an out-of-state corporation is a necessary predicate "before *any* tax may be levied" by a State. *Commonwealth Edison Co. v. Montana*, 453 U.S. 609,

626 (1981). *Quill* itself recognized that this Court's prior cases upholding state taxes have all "involved taxpayers who had a physical presence in the taxing State." *Quill*, 504 U.S. at 314.

Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977), is not to the contrary. In that decision, this Court included the "substantial nexus" requirement as part of the four-prong test to determine whether the imposition of a state tax is permissible under the Commerce Clause, but no distinction was made between the types of state tax at issue. As such, even though *Complete Auto* addressed the constitutionality of a state use tax, (where the physical presence requirement of *Bellas Hess* and *Quill* would unquestionably apply), this Court relied equally on its franchise tax precedent. *See id.* at 285-287 (citing *Colonial Pipeline Co. v. Traigle*, 421 U.S. 100, 101 (1975)).

In the years that have followed since *Complete Auto*, this Court has applied that four-prong analysis on several occasions to assess the constitutionality of state income taxes. *See, e.g. Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425 (1980); *Amerada Hess Corp. v. Director, Div. of Taxation*, 490 U.S. 66 (1989); *Trinova Corp. v. Michigan Dep't of Treasury*, 498 U.S. 358 (1991); *Barclays Bank PLC v. Franchise Tax Bd.*, 512 U.S. 298 (1994). And this Court has rejected the argument, advanced by several States, that the "decision in *Complete Auto* undercut the *Bellas Hess* rule." *Quill*, 504 U.S. at 311-312.

The label that a State gives a tax cannot permit that tax to evade constitutional review. The *Complete Auto* Court recognized that redefining a tax one way or another will not result in a different analysis or result under the Constitution. "A tailored tax, *however accomplished*, must receive the careful scrutiny of the courts to determine whether it produces a forbidden effect on interstate commerce." *Complete Auto*, 430 U.S. at 288 n.15 (emphasis added). A court must "look[] past 'the formal language of the tax statute [to] its practical effect.'" *Quill*, 504 U.S. at 310 (quoting *Complete Auto*, 430 U.S. at 279) (second brackets in original). Accordingly, in discussing the Commerce Clause's substantial nexus requirement, this Court has routinely referred to cases involving sales and use taxes interchangeably with cases involving direct taxes such as income taxes, undermining the notion that respondent pressed below (and the state court adopted) that there are different substantial nexus requirements for different kinds of state taxes. *See, e.g.*, *National Geographic Soc'y v. California Bd. of Equalization*, 430 U.S. 551, 555-559 (1977).

There is no logical reason that a State should be able to impose state income taxes on an out-of-state corporation that does not maintain a physical presence in that State when it cannot, under the Commerce Clause, impose state sales and use taxes on that out-of-state corporation.

b. Application of the physical presence requirement articulated in *Quill* and *Bellas Hess* to

state imposition of income taxes on out-of-state corporations is entirely consistent with the core principles that undergird the Commerce Clause. In declining to overrule *Bellas Hess*, the *Quill* Court reaffirmed that the Commerce Clause was intended to address "structural concerns about the effects of state regulation on the national economy" because, under the Articles of Confederation, "state taxes and duties [had] hindered and suppressed the interstate commerce." *Quill*, 504 U.S. at 312.

The economic nexus rationale set forth by the Massachusetts court below, as well as by some of the other state courts to have decided this issue, was plainly rejected by this Court in *Quill*. *See MBNA*, 640 S.E.2d at 241 (Benjamin, J., dissenting) (noting that this Court rejected the "economic exploitation nexus" arguments in *Bellas Hess* and *Quill*). In *Quill*, the State had argued that because the out-of-state corporation had derived significant revenues from in-state customers, the corporation should have paid tax to that State on that income. The State also argued that: (1) the out-of-state corporation received benefits from the taxing State; (2) such a corporation would be at a competitive advantage vis-à-vis in-state merchants who necessarily must collect the tax; and (3) the physical presence rule was rendered obsolete by the technological and economic changes of the late Twentieth Century. But this Court correctly concluded that none of these arguments in *Quill* justified a departure from the physical presence

requirement. And there is no reason why they should lead to a different result today merely because an income, rather than sales or use, tax is at issue.

Indeed, the ruling below, by cabining *Quill* and *Bellas Hess* to sales and use taxes only, has imposed a constitutional regime in which States can reach the very transactions the Constitution seeks to protect from state interference. As this Court has previously made clear, the economic burdens on interstate commerce posed by imposition of state income taxes on out-of-state corporations are actually greater than the consequences of sales and use tax collection obligations. *National Geographic*, 430 U.S. at 558. The state taxes invalidated in *Bella Hess* and *Quill* were not direct taxes on out-of-state corporations but, instead, were obligations to collect sales and use taxes from in-state customers. By contrast, income and franchise taxes are *direct* taxes imposed on the out-of-state corporation.

As such, it would make no sense for the administrative burden of a collection obligation for sales and use taxes to violate the Commerce Clause due to the absence of any physical presence by the out-of-state corporation, *see Quill*, 504 U.S. at 313 n.6, but for no such violation to occur where there is not only an administrative burden but also an immediate financial obligation of an income tax for what might amount to that same sale by the

out-of-state corporation that maintains no physical presence in the State.[5]

c. The physical presence requirement of *Bellas Hess* and *Quill* is supported not only in the context of sales and use taxes, but also with regard to income taxes, by basic federalism principles.

Although the modern economy may lack physical borders, States do not. In the years since *Quill*, this Court has consistently reaffirmed the constitutional limitations on a State's ability to regulate economic activity beyond its geographic border. *See, e.g.*, *State Farm Mut. Auto. Ins. Co. v. Campbell*, 538 U.S. 408, 421 (2003); *BMW of N. Am., Inc. v. Gore*, 517 U.S. 559, 569-571 (1996); *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 821-823 (1985); *see also Granholm v. Heald*, 544 U.S. 460, 472 (2005) (noting that the

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[5] Congress has mandated in 15 U.S.C. § 381 that there is a minimum standard for State imposition of net income tax that provides that no State may impose such a tax "on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person" are based solely on solicitations of orders in the State for sales of tangible personal property that are approved or rejected outside the State, and/or solicitations of such orders for the benefit of a customer. 15 U.S.C. § 381(a). States thus have targeted out-of-state corporations that earn income from customers located in their State or from intangible property used in their State, *e.g.*, businesses owning intellectual property, computer software firms, credit card businesses, music publishers, and service providers. Of course, Congress's imposition of a minimum standard says nothing about the constitutionality of the reach of the state tax to the situation presented here.

Commerce Clause was intended to "minim[ize]" the potential for "[r]ivalries among the States").

If the physical presence of a taxpayer in the taxing State becomes irrelevant to a State's power over the taxpayer, and a State is allowed to exert broad taxing authority solely on the basis of activity in commercial markets, then state regulatory power becomes effectively unmoored from the very feature of the State that gives it constitutional status—*viz.*, its sovereignty over a specified geographical area and those who come within it. For that reason, this Court has explicitly held that "[i]n a Union of 50 States, to permit each State to tax activities outside its borders would have drastic consequences for the national economy, as business could be subjected to severe multiple taxation." *Allied-Signal, Inc. v. Director, Div. of Taxation*, 504 U.S. 768, 777-778 (1992).

2. Any Ambiguity In The Reach Of *Quill's* Constitutional Ruling Should Be Resolved By This Court And Not Left To A Disagreement Among The State Courts

a. Several state courts, including the court below, *see* App., *infra*, 43a; *Capital One*, 899 N.E.2d at 12, have limited *Quill* and *Bellas Hess* to sales and use taxes and have declined to apply that precedent to income taxes based upon the following observation in *Quill*:

> [A]lthough in our cases subsequent to *Bellas Hess* and concerning other types of taxes we have not adopted a similar bright-line, physical presence requirement, our reasoning in those cases does not compel that we now reject the rule that *Bellas Hess* established in the area of sales and use taxes.

Quill, 504 U.S. at 317; *see also id.* at 314 ("Although we have not, in our review of other types of taxes, articulated the same physical-presence requirement that *Bellas Hess* established for sales and use taxes, that silence does not imply repudiation of the *Bellas Hess* rule.").

Those statements do not, however, provide States with a justification to exclude income-based taxes from this Court's physical presence requirement. That is particularly true in light of this Court's longstanding precedents which do not impose different Commerce Clause tests depending upon the state tax at issue. *See* pages 22-27, *supra*.

Nevertheless, the disparate decisions of 16 state courts demonstrate that this language in *Quill* has created ambiguity. That provides yet another reason for this Court to grant this petition and clarify the implications of this dictum.

b. Even if this Court were to view the state courts that have refused to apply *Bellas Hess* and *Quill* to income taxes to be correct, it is for this Court to rule on the question. As Justice Scalia explained in

his opinion concurring in part and concurring in the judgment in *Quill*, "if a precedent of this Court has direct application in a case, yet appears to rest on reasons rejected in some other line of decisions, [courts] should follow the case which directly controls, leaving to this Court the prerogative of overruling its own decisions." *Quill*, 504 U.S. at 320 (Scalia, J., concurring in part and concurring in the judgment) (citation omitted).

Moreover, this Court's ruling on the question presented is necessary because the absence of this Court's intervention has led some state courts to believe that this Court has rejected the physical presence requirement for state income tax cases merely because the Court has denied *certiorari* in certain cases. *Praxair Technology, Inc. v. Director, Div. of Taxation*, No. 007445-05 (N.J. Tax Ct. June 27, 2007) (Order Granting Partial Summ. J.), *rev'd and remanded*, 404 N.J. Super. 287, 291 (N.J. Super. Ct. App. Div. 2008) (viewing this Court's denials of *certiorari* as "signaling" its decision on the merits of this issue).

3. A Bright-Line, Physical Presence Requirement Provides A Judicially Manageable Rule, Whereas An Economic Nexus Standard Would Be Unmanageable And Subject To Manipulation

The requirement that a State not impose state taxation on an out-of-state corporation unless that

corporation maintains a physical presence in the taxing State provides a principled and judicially manageable rule that "encourages settled expectations and, in doing so, fosters investment by businesses and individuals." *Quill*, 504 U.S. at 316.

One of the foremost experts in State taxation, Professor Richard D. Pomp, explained that the "physical presence is to be preferred to economic presence as a nexus standard" because it is "more likely to reduce litigation and foster interstate investment, less likely to discriminate against the service sector, less likely to lead to multiple taxation, more easily administered, and more compatible with the growth of electronic commerce." App., *infra*, 143a. An economic nexus standard, on the other hand, "is amorphous and easily malleable" and "is less a legal principle and more an invitation to chaos and multiple taxation." *Ibid.*

Indeed, the vagaries of the economic nexus test, as opposed to the physical presence test, are plainly demonstrated by the courts that have applied it. The Massachusetts court held that "substantial nexus" is an "elastic" test that purportedly "means a greater presence, both qualitatively and quantitatively, than the minimum connection between a State and a taxpayer that would satisfy a due process inquiry," yet in the State's view this elastic text can be satisfied by virtually any commercial arrangement with individuals or entities in the taxing State.

Capital One, 899 N.E.2d at 15; *see also* App., *infra*, 3a.[6]

West Virginia courts look to whether there is any significant "economic presence" in the State. *MBNA*, 640 S.E.2d at 234. And other state courts have similarly based their decisions on some amorphous threshold requirement of minimum economic or commercial activity directed at the taxing State. *General Motors*, 25 P.3d 1028-1029.

These nonstandards provide no guidance to the courts that must apply them or to the out-of-state corporations that must abide by them. And the flexible—*i.e.*, malleable—nature of these tests has been justified by the limitless rationale that those "who adopted the Commerce Clause lived in a world that is impossible for people living today to imagine" so that there must be "a fresh application of Commerce Clause principles tempered with healthy

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[6] The Massachusetts Department of Revenue Directive 96-2, on which the State relied in this case, finds a substantial nexus any time an out-of-state corporation's intangible property "generates gross receipts" through a "contract with an in-state company" and the presence of the "intangible property" and the out-of-state corporation's "activities with respect to that property" are "more than de minimis." Mass. Dep't of Revenue Directive 96-2. Under this standard, it is difficult to conceive of a circumstance where the use for profit in Massachusetts of intangible property owned by an out-of-state corporation would not in the State's view result in a substantial nexus that authorizes state taxation of the out-of-state corporation.

doses of fairness and common sense" to adapt to the modern world. *MBNA*, 640 S.E.2d at 236.

That rationale, rooted in the speed and scope of modern interstate commerce arrangements, is symptomatic of the problem with the economic nexus standard. It means that the Commerce Clause has become nugatory, because economic transactions no longer yield to State borders, so that a State can regulate any interstate commerce that involves a customer who lives within the taxing State, contrary to this Court's longstanding precedent.

C. The Continued Departure By State Courts And Taxing Authorities From The Physical Presence Requirement Has Severe Economic Implications

1. The Conflict In The State Courts Creates Economic Uncertainty On An Issue That Is Worth Billions Of Dollars Annually To Corporations Such As Petitioner And The States

The uncertainty caused by the continued proliferation of the now 16-State conflict in the state courts significantly hinders business planning and investment at a time our Nation can ill afford it. This issue affects all sorts of corporations—from petitioner, to the credit card companies in *Capital One*, to authors and music publishers, to software companies, and to many others. It is estimated to be worth billions of dollars annually. That means that until

this Court resolves this undecided constitutional issue, state courts will continue to divergently decide who—the State or the out-of-state corporation without a physical presence in the State—has a right to this money.

A corporation attempting to order its business affairs and determine in what States it can be subjected to state income and franchise tax currently is faced with the prospect of different conclusions in different States, depending not on any difference in the extent of the connection between the corporation and the State but, instead, on the difference in how the state courts may interpret the federal Constitution. Such uncertainty inhibits strategic business planning and investment and is extraordinarily costly. Reliance interests need to be respected and the clarity provided by *Quill* restored. Absent clear guidance from this Court, there is no reliable way for businesses to predict how far jurisdictions will assert taxation authority in the future, and whether such exercise of taxing authority will be upheld by the courts.

States have also begun to sustain the imposition of substantial, non-deductible and often unabateable penalties on out-of-state corporations that had relied (and continue to rely) on this Court's holdings in *Quill* and *Bellas Hess* that physical presence is a prerequisite for nexus under the Commerce Clause.

The need for clarity on this issue is particularly important in light of requirements for corporate

transparency. The Financial Accounting Standards Board Interpretation No. 48 (FIN 48), which is entitled Accounting for Uncertainty in Income Taxes, sets forth how a corporation must account for and disclose its income tax positions. In particular, FIN 48 requires a company to determine whether it is "more likely than not" that its positions would be upheld by the court of last resort. If it is not more likely than not that a position will be upheld, the corporation cannot recognize a benefit for such position in its financial statements. Financial Accounting Standards Board, *Accounting for Uncertainty in Income Taxes—An Interpretation of FASB Statement No. 109*, App. A, A2 (2008). Although the court of last resort on constitutional questions is this Court, some auditors are requiring that no benefit be taken on economic nexus positions due solely to the conflict on this issue in the State courts that has not yet been resolved by Congress or this Court. That results in profound consequences for the publicly reported financial health of a corporation, for shareholder value, and the ability to raise capital in this particularly uncertain economic time.

Although a remarkably large number of States have litigated this issue to completion, two thirds of the States have not yet conclusively weighed in on this issue. The likely continued litigation of the issue in these other States will not resolve the entrenched disagreement in the state courts, and it will continue to generate enormous—and enormously wasteful—litigation costs. *Cf. Quill*, 504 U.S. at 315

(noting that a clear rule establishing the boundaries of state taxation authority would "reduc[e] litigation concerning those taxes").[7]

2. The Economic Nexus Standard Has Adverse Global Implications

Tax jurisdiction is not just a national issue. Under most international tax treaties to which the United States is a signatory, the United States has agreed to tax foreign corporations only if they have a "permanent establishment" in the United States, which is normally defined as a "fixed place of business through which the business of an enterprise is wholly or partly carried on." U.S. Model Income Tax Convention art. 5(1), Sept. 20, 1996. A foreign corporation thus is not subject to United States income tax unless it is physically present in this country. That "permanent establishment" requirement is widely used in the international arena because of its clarity, reliability, and fairness, which

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[7] In addition to statutory, regulatory, and other publicly announced economic nexus positions and cases pending before or decided by State administrative tribunals, there also is ongoing litigation in certain States that has not yet resulted in appellate court decisions. *See, e.g.*, *MBNA America Bank, N.A. v. Indiana Dep't of State Revenue*, 895 N.E.2d 140 (Ind. Tax Ct. 2008) (case presenting same issue that has recently come out of the tax court in Indiana and likely to proceed to higher state court).

all are principles of tax policy that apply equally in the State tax arena.[8]

These treaties also are of particular concern because they generally do not limit the power of States and localities to impose taxes on foreign corporations. *See Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 196-197 (1983). Consequently, if the decision below is permitted to stand, a foreign corporation without a permanent establishment in the United States could find itself subject to tax by States that reject a physical presence requirement, even though the foreign corporation would not be subject to federal income tax. *Cf. Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 448 (1979) (noting that "a state tax on the instrumentalities of foreign commerce may impair federal uniformity in an area where federal uniformity is essential").

In addition to the practical problems that could arise (most State tax returns use federal income tax returns as their starting point in computing tax

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[8] The permanent establishment provision was introduced by the League of Nations in 1927 (*see Reports Presented by the Comm. of Technical Experts on Double Taxation and Tax Evasion*, League of Nations Doc. C.216M.85 1927 II (1927) (presenting Draft Bilateral Convention for the Prevention of Double Taxation)), and has been incorporated into virtually all international tax treaties ever since. *See generally* Gary D. Sprague & Rachel Hersey, *Permanent Establishments and Internet-Enabled Enterprises: The Physical Presence and Contract Concluding Dependent Agent Tests*, 38 Ga. L. Rev. 299 (2003).

liability), there would be an "enhanced risk of multiple taxation" and the United States would be prevented from "speak[ing] with one voice" with respect to international trade, which are considerations that must be addressed, in addition to the *Complete Auto Transit* tests, when foreign commerce is implicated. *See Container Corp.*, 463 U.S. at 185; *Barclays Bank PLC v. Franchise Tax Bd.*, 512 U.S. 298, 311 (1994) (citation omitted).

CONCLUSION

For the reasons set forth above, the petition for a writ of *certiorari* should be granted.

Respectfully submitted,

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March 2009

APPENDIX A

COMMONWEALTH OF MASSACHUSETTS

SUPREME JUDICIAL COURT
FOR THE COMMONWEALTH

AT BOSTON, 8 January 2009

IN THE CASE NO. SJC-10106

GEOFFREY, INC.

vs.

COMMISSIONER OF REVENUE

pending in the Appellate Tax Board
No. C271816-03-COR

ORDERED, that the following entry be made in the docket; viz., –

Decision of the Appellate Tax Board affirmed.

BY THE COURT,

/s/ Susan Mellen
Clerk
Supreme Judicial Court
For the Commonwealth

DATED: January 8, 2008

See opinion on file.

GEOFFREY, INC. *vs.*
COMMISSIONER OF REVENUE.

Suffolk. October 7, 2008. – January 8, 2009.

Present: Marshall, C.J., Ireland, Spina, Cowin, Cordy, & Botsford, JJ.

Appeal from a decision of the Appellate Tax Board.

The Supreme Judicial Court granted an application for direct appellate review.

Paul H. Frankel, of New York (*Maxwell D. Solet* with him) for the taxpayer.

Thomas A. Barnico, Assistant Attorney General, for Commissioner of Revenue.

SPINA, J. The present appeal is from a decision of the Appellate Tax Board (board) affirming the denial by the Commissioner of Revenue (commissioner) of an application by the taxpayer, Geoffrey, Inc. (Geoffrey), for the abatement of corporate excises assessed for the tax years ending January 31, 1997, through January 31, 2001. We granted Geoffrey's application for direct appellate review. At issue is whether, consistent with the commerce clause, art 1, § 8, of the United States Constitution,[1] the Commonwealth can impose a

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[1] The commerce clause authorizes Congress to "regulate Commerce . . . among the several States." Art. 1, § 8, of the United States Constitution.

corporate excise tax, pursuant to G. L. c. 63, § 39, on a foreign corporation[2] that does not have a physical presence in Massachusetts. In our decision in *Capital One Bank v. Commissioner of Revenue, ante* ___, ___ (2008) (*Capital One*), released today, we concluded that the constitutionality, under the commerce clause, of the Commonwealth's imposition of an income-based excise on an out-of-State entity is not determined by the "physical presence" test articulated in *Quill Corp. v. North Dakota,* 504 U.S. 298, 317-318 (1992) (*Quill*), but by the "substantial nexus" test articulated in *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274, 279 (1977) (*Complete Auto*). Our holding in *Capital One* is controlling with respect to Geoffrey's constitutional claim. For the reasons that follow, we now affirm the decision of the board.

The board found the following facts, based on the parties' stipulations of facts and the testimony and exhibits introduced at the hearing. See G. L. c. 58A, § 13 ("The decision of the board shall be final as to findings of fact"); *United Church of Religious Science v. Assessors of Attleboro,* 372 Mass. 280, 281 (1977).

On January 24, 1984, Geoffrey was incorporated in Delaware as a wholly owned subsidiary of Toys "R"

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[2] A "[f]oreign corporation" is defined as a "corporation, association, or organization established, organized or chartered under laws other than those of the commonwealth." G. L. c. 63, § 30(2).

Us, Inc. (Toys Inc.), a Delaware corporation.[3] Effective August 1, 1984, Toys Inc. transferred trademarks, trade names, and service marks (collectively, trademarks) to Geoffrey in exchange for stock. Included in this transfer were the "Toys 'R' Us" and "Kids 'R' Us" trademarks and the "Geoffrey" giraffe character logo. A 1991 appraisal by Arthur Andersen & Co. determined that the fair market value of the intellectual property owned by Geoffrey was $1.5 billion. Geoffrey's business activities consisted of licensing the trademarks to various Toys Inc. subsidiaries and affiliates for use in their retail operations throughout the United States. Geoffrey had no employees or offices in Massachusetts, and it owned no tangible property, real or personal, in this Commonwealth. The trademarks were registered with the United States Patent and Trademark Office.

Toys "R" Us-Mass, Inc. (TRUMI), was another subsidiary of Toys Inc. During the tax years at issue, TRUMI operated twenty-six Toys "R" Us and Kids "R" Us retail stores in the Commonwealth. Pursuant to a licensing agreement dated May 3, 1992, Geoffrey permitted TRUMI to use the "Toys 'R' Us" and "Kids 'R' Us" trademarks solely in Massachusetts in exchange for royalty payments to Geoffrey at a rate of three per cent of TRUMI's net sales at Toys "R" Us

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[3] For the first four tax years at issue, Geoffrey's principal place of business was in Wilmington, Delaware. On January 1, 2000, Geoffrey moved its principal place of business to Paramus, New Jersey.

stores, and two per cent of its net sales at Kids "R" Us stores. This agreement was made subject to the laws of Delaware. TRUMI filed Massachusetts corporate excise tax returns on a separate company basis, and it claimed a deduction for a portion of the royalties paid to Geoffrey.

In February, 1997, Geoffrey entered into a similar licensing agreement with Babies "R" Us, a division of Baby Superstore, Inc. (Baby Superstore), which was an affiliate of TRUMI, for the use of Geoffrey's "Babies 'R' Us" trademark. During the tax years at issue, Babies "R" Us operated three retail stores in the Commonwealth. Pursuant to this licensing agreement, Babies "R" Us paid Geoffrey royalties at a rate of one per cent of its net sales for the 1996 fiscal year, one and one-half per cent of its net sales for the 1997 fiscal year, and two per cent of its net sales for the remaining years of the agreement.

Geoffrey's trademarks appeared on signage, store displays, and product packaging at Massachusetts stores operated by TRUMI and Baby Superstore. The trademarks were intended to demonstrate to consumers that goods and services sold by licensees were of high quality and good value. Pursuant to the licensing agreements, Geoffrey had the right to review product samples and specifications, signs, labels, tags, packaging materials, advertising and sales promotion materials, catalogues, and pamphlets that displayed the trademarks. TRUMI and Baby Superstore agreed to comply with Geoffrey's

instructions to ensure that the trademarks did not become generic, which could adversely affect Geoffrey's interests in them. Geoffrey received over $33 million in royalty income from retail stores located in Massachusetts during the tax years at issue.[4]

Under a quality control, legal and treasury service Agreement dated February 3, 1996, Toys Inc. provided advice and assistance to Geoffrey with respect to investment opportunities, accounting matters, and licensing issues. In particular, Toys Inc. dedicated the services of an intellectual property specialist to the task of protecting Geoffrey's assets. Toys Inc. also employed regional and district managers with responsibilities for Massachusetts stores who could monitor the use of the trademarks in the Commonwealth and would bring store problems to the attention of appropriate officials. Reports from Toys Inc. explaining the results of its quality control activities were provided to Geoffrey. For its services, Toys Inc. was paid $300,000 annually. In addition, Geoffrey had access to State and Federal courts in Massachusetts to protect its interests in its

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[4] Geoffrey's annual royalty income from retail stores in the Commonwealth was as follows: $5,928,567, for the tax year ending February 1, 1997; $6,554,265 for the tax year ending January 31, 1998; $6,628,656 for the tax year ending January 30, 1999; $7,117,981 for the tax year ending January 29, 2000; and $7,423,420 for the tax year ending February 3, 2001.

trademarks and its entitlement to royalty payments under the licensing agreements.

During an audit of TRUMI in 2002, the Department of Revenue (department) discovered that Geoffrey had been receiving royalty income under the licensing agreement with TRUMI, but had not been filing corporate excise returns in Massachusetts.[5] On October 2, 2002, the department issued to Geoffrey a notice of failure to file corporate excise returns for the tax years at issue. In response, Geoffrey provided the department with unsigned, pro forma returns for the relevant years. On December 14, 2002, the department issued to Geoffrey a notice of intent to assess, which was subsequently revised on December 23, 2002. Approximately one month later, the department sent Geoffrey a notice of assessment for the tax years at issue in the amount of $3,143,445, consisting of $1,692,568 in corporate excise taxes, $645,008 in accrued interest, and $805,865 in penalties.[6] Geoffrey filed a timely application for abatement, claiming that it was not obligated to pay such taxes because it had no nexus with the Commonwealth. See G. L. c. 62C, § 37. On September

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[5] Similarly, separate royalty income paid to Geoffrey by Baby Superstore pursuant to its licensing agreement had not been reported to the department and would become part of the tax assessment.

[6] The parties' second supplemental stipulation of facts corrected the amount of the assessment to $2,456,435, consisting of $1,257,793 in corporate excise taxes, $567,101 in accrued interest, and $631,541 in penalties.

19, 2003, the commissioner denied the application, and Geoffrey appealed to the board pursuant to G. L. c. 62C, § 39.

In affirming the commissioner's denial of the abatement, the board stated that Geoffrey's business activities in Massachusetts constituted a "substantial nexus" with the Commonwealth that justified imposition of the corporate excises for the tax years at issue. In particular, the board based its determination on Geoffrey's purposeful efforts to reap economic benefits from the Commonwealth's retail marketplace by licensing the trademarks for use by TRUMI and Baby Superstore. The trademarks, the board pointed out, were used extensively by Toys "R" Us, Kids "R" Us, and Babies "R" Us stores in Massachusetts, and such use resulted in Geoffrey's receipt of substantial royalty income. The board also noted that Geoffrey retained the right to regulate use of the trademarks, and was afforded access to State and Federal courts in Massachusetts to protect its interests.[7] Consequently, the board concluded that the Commonwealth's assessment of corporate excise taxes on Geoffrey was constitutional under the Federal commerce clause. The board further stated that Geoffrey did not demonstrate that it had acted with reasonable cause in failing to file returns or pay corporate excises for the tax years at issue, and

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[7] Geoffrey points out that it did not use State or Federal courts in Massachusetts during the tax years at issue to protect its intellectual property rights.

therefore, Geoffrey was not entitled to abatement of the penalties assessed pursuant to G. L. c. 62C, § 33.[8]

A decision by the board will not be modified or reversed if the decision "is based on both substantial evidence and a correct application of the law." *Boston Professional Hockey Ass'n v. Commissioner of Revenue,* 443 Mass. 276, 285 (2005). We presume that a tax is constitutionally valid unless the party challenging it establishes its invalidity "beyond a rational doubt." *Andover Sav. Bank v. Commissioner of Revenue,* 387 Mass. 229, 235 (1982). While we give deference to the board's expertise in interpreting the tax laws of the Commonwealth, see *French v. Assessors of Boston,* 383 Mass. 481, 482 (1981), we apply our independent judgment as to both the law and the facts on constitutional issues. See *Opinion of the Justices,* 328 Mass. 679, 687 (1952).

Pursuant to G. L. c. 63, § 39, "every foreign corporation, exercising its charter, or qualified to do business or actually doing business in the

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[8] In its appeal to the Appellate Tax Board (board), Geoffrey also took issue with the apportionment of its income on the ground that it resulted in the taxation of extraterritorial values. General Laws c. 63, § 38, provides that the net income of a foreign corporation derived from business activity that is taxable both within and without the Commonwealth shall be apportioned in accordance with a specified statutory formula. The board concluded that the apportionment formula was calculated correctly with respect to Geoffrey's income. Geoffrey has not challenged this determination in the present appeal, so we need not consider it further.

commonwealth, or owning or using any part or all of its capital, plant or any other property in the commonwealth, shall pay, on account of each taxable year, the [specified] excise." The Legislature has stated that the purpose of § 39 is to require foreign corporations to pay "for the enjoyment under the protection of the laws of the commonwealth, of the powers, rights, privileges and immunities derived by reason of the corporate form of existence and operation." *Id.* In accordance with G. L. c. 62C, § 3, "[t]he commissioner may prescribe regulations and rulings, not inconsistent with law, to carry into effect the provisions of [G. L. c. 63, § 39], which regulations and rulings, when reasonably designed to carry out the intent and purposes of said provisions, shall be prima facie evidence of their proper interpretation." Pursuant to this authority, the commissioner promulgated 830 Code Mass. Regs. § 63.39.1 (1993), which "describes the circumstances under which a foreign corporation is subject to the tax jurisdiction of Massachusetts under [ ] G. L. c. 63, § 39." 830 Code Mass. Regs. § 63.39.1(1)(a). As is pertinent here, "a foreign corporation must file a return in Massachusetts and pay the associated excise if . . . the corporation owns property that is held by another in Massachusetts under a lease, consignment, *or other arrangement*" (emphasis added). 830 Code Mass. Regs. § 63.39.1(4)(d)(1). The licensing of the trademarks by Geoffrey to TRUMI and Baby Superstore would be one type of "other arrangement" that would subject Geoffrey to the corporate excise tax under G. L. c. 63, § 39.

That said, the thrust of Geoffrey's appeal is that, because Geoffrey had no physical presence in Massachusetts, the imposition of the corporate excise under § 39 violated the Federal commerce clause.[9] We disagree.

As we stated at the outset of this opinion, resolution of the physical presence issue under commerce clause analysis is governed by our decision in *Capital One, supra.* We now conclude that substantial nexus can be established where a taxpayer domiciled in one State carries on business in another State through the licensing of its intangible property that generates income for the taxpayer. In reaching this conclusion, we join other jurisdictions that have considered the physical presence issue in the context of intangible property and have upheld the imposition of income-based tax assessments. See *Geoffrey, Inc. v. South Carolina Tax Comm'n,* 313 S.C. 15, 23-24, cert. denied, 510 U.S. 992 (1993) (licensing intangible property for use in taxing State and deriving income from such use established substantial nexus for imposition of income-based tax in conformity with commerce clause); *Bridges v.*

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[9] A State's ability to tax businesses operating in interstate commerce also is constrained by the due process clause of the Fourteenth Amendment to the United States Constitution. See *Capital One Bank v. Commissioner of Revenue, ante* ___, ___ n.14 (2008). Geoffrey does not challenge the imposition of the corporate excise tax on the ground that Geoffrey's purported "economic presence" in Massachusetts was insufficient to satisfy the "minimum contacts" standard of the due process clause.

Geoffrey, Inc., 984 So. 2d 115, 128 (La. Ct. App. 2008) (same); *Geoffrey, Inc. v. Oklahoma Tax Comm'n*, 132 P.3d 632, 638-639 (Okla. Ct. App. 2005) (same). See also *Lanco, Inc. v. Director, Div. of Taxation*, 379 N.J. Super. 562, 573 (App. Div. 2005), aff'd, 188 N.J. 380, 383 (2006) (per curiam), cert. denied, 127 S. Ct. 2974 (2007) (concluding that State may constitutionally subject foreign corporation to business tax where corporation lacks physical presence in State but derives income from licensing agreement with company conducting retail operations in State); *Kmart Props., Inc. v. Taxation & Revenue Dep't of N.M.*, 139 N.M. 177, 186 (Ct. App. 2001) (stating that "the use of KPI's marks within New Mexico's economic market, for the purpose of generating substantial income for KPI, establishes a sufficient nexus between that income and the legitimate interests of the state and justifies the imposition of a state income tax"), rev'd on other grounds, 139 N.M. 172 (2005); *A & F Trademark, Inc. v. Tolson*, 167 N.C. App. 150, 162 (2004), cert. denied, 546 U.S. 821 (2005) (concluding that where out-of-State company licenses trademarks to related in-State retail company, there exists substantial nexus with taxing State to satisfy commerce clause). See generally 1 J.R. Hellerstein & W. Hellerstein, State Taxation § 6.11 (3d ed. 2007) (exploitation of intangible property rights in State as basis for jurisdiction to tax out-of-State persons deriving income from such property). Contrast *Rylander v. Bandag Licensing Corp.*, 18 S.W.3d 296, 299, 301 (Tex. Ct. App. 2000) (concluding that franchise tax based solely on

taxpayer's mere possession of license to do business in Texas was invalid, but not addressing whether royalty payments from licensing of intangibles were sufficient to satisfy substantial nexus test).

Here, Geoffrey engaged in business activities with a substantial nexus to Massachusetts during the tax years at issue. Geoffrey entered into contractual relationships, in the form of licensing agreements, with TRUMI and Baby Superstore and permitted those entities to use the trademarks exclusively in Massachusetts; Geoffrey encouraged Massachusetts consumers to shop at Toys "R" Us, Kids "R" Us, and Babies "R" Us through an implicit promise, manifested by the trademarks, that the products at those stores would be of good quality and value; Geoffrey relied on employees at TRUMI to maintain a positive retail environment, including store cleanliness and proper merchandise display; and Geoffrey reviewed licensed products and materials that would be sold in the Commonwealth to ensure high standards and to maintain its positive reputation with Massachusetts consumers, thereby generating continued business and substantial profits. Geoffrey's annual royalty income from retail stores in the Commonwealth for the tax year ending February 1, 1997, was $5,928,567, and it increased to $7,423,420, by the tax year ending February 3, 2001. Based on the findings of the board, we conclude that Geoffrey's activities established a substantial nexus with Massachusetts, and, therefore, the assessment of the corporate excises, pursuant to G. L. c. 63, § 39,

for the tax years at issue comported with the commerce clause.[10]

Geoffrey also contends that the board erred in failing to abate the assessed penalties where the United States Supreme Court's decisions in *National Bellas Hess, Inc. v. Department of Revenue of Ill.*, 386 U.S. 753, 758-760 (1967), and *Quill, supra,* gave Geoffrey reasonable cause to believe that, in the absence of a physical presence in the Commonwealth, it was not subject to Massachusetts corporate excise taxes. At the very least, Geoffrey continues, it should not be penalized for its plausible interpretation of *Quill*, even if such interpretation ultimately proved to be incorrect. In Geoffrey's view, it exercised

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[10] Closely related to the requirement of "substantial nexus" for imposition of an income-based excise on an out-of-State corporation is the requirement that the tax be "fairly related to the services provided by the State." *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274, 279 (1977). In its brief, Geoffrey suggests that, without physical presence, it would be difficult to conclude that the corporate excise taxes assessed here were "fairly related to" actual benefits provided by the Commonwealth. Geoffrey's appeal to the board focused on the substantial nexus prong of the *Complete Auto* test. Consequently, the board did not address whether the corporate excise tax was fairly related to services provided by the Commonwealth. Generally speaking, a corporation engaged in business activities in Massachusetts could be the beneficiary of services provided by the State, even in the absence of physical presence. For example, growth in the retail marketplace may necessitate governmental action to address increased traffic on Massachusetts roads, potentially greater demands on the Commonwealth's labor force, and the necessity for adequate police and fire protection.

ordinary business care and prudence. Further, Geoffrey argues that it should not be penalized for what it characterizes as the commissioner's lack of a clear policy in this area of taxation. See, e.g., *Sherwin-Williams Co. v. Commissioner of Revenue,* 438 Mass. 71, 72-73 (2002) (commissioner challenged intercompany royalty payments for lacking economic substance, but did not attempt to tax out-of-State affiliated licensor).

Pursuant to G. L. c. 62C, § 33, the commissioner shall assess penalties on a taxpayer for failure to file timely returns and failure to pay taxes. General Laws c. 62C, § 33(*f*), provides for an abatement of penalties "[i]f it is shown that any failure to file a return or to pay a tax in a timely manner is due to reasonable cause and not due to willful neglect." Reasonable cause will be established where, at a minimum, a taxpayer has demonstrated that "he exercised the degree of care that an ordinary taxpayer in his position would have exercised." *Commissioner of Revenue v. Wells Yachts S., Inc.,* 406 Mass. 661, 665 (1990).

In 1996, the commissioner issued DD 96-2 (directive), Official MassTax Guide 115-118 (West Supp. 1996), which set forth the commissioner's position as to when the ownership and use of intangible property in the Commonwealth would subject a foreign corporation to corporate excise

taxes.[11] The directive states that "[t]he definition of intangible property generally includes, but is not limited to, copyrights, patents, trademarks, trade names, trade secrets, service marks, and know-how." It further provides:

> "A foreign corporation's intangible property used within Massachusetts will subject that corporation to the corporate excise when:
>
> "1. The intangible property generates, or is otherwise a source of, gross receipts within the state for the corporation, including through a license or franchise; and
>
> "2. The activity through which the corporation obtains such gross receipts from its intangible property is purposeful (e.g., a contract with an in-state company); and
>
> "3. The corporation's presence within the state, as indicated by its intangible property and its activities with respect to that property, is more than de minimis."

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[11] The purposes of such public written statements "are to inform Department [of Revenue] personnel and the public of Department policy and practice, thereby promoting the uniform application of the Massachusetts tax laws by the Department and assisting taxpayers in complying with the Massachusetts tax laws." 830 Code Mass. Regs. § 62C.3.1(6)(c) (1993). A directive "states the official position of the Department," and it will be used "as precedent in the disposition of cases unless and until it is revoked or modified." *Id.* at § 62C.3.1(6)(d) (1993).

The board acted within its discretion in refusing to abate the penalties levied on Geoffrey. The Supreme Court's decision in *Quill* discussed a "physical-presence" requirement under the commerce clause only in the context of sales and use taxes. See *Quill Corp. v. North Dakota,* 504 U.S. 298, 314, 317 (1992). Prior to the tax years at issue here, the South Carolina Supreme Court in *Geoffrey, Inc. v. South Carolina Tax Comm'n,* 313 S.C. 15, 23-24 (1993), addressed the same constitutional issue as presented in this case with regard to the same taxpayer under a similar factual scenario and concluded that "by licensing intangibles for use in [South Carolina] and deriving income from their use [there], Geoffrey ha[d] a 'substantial nexus' with South Carolina." In addition, the commissioner's issuance of the directive clarified the Commonwealth's tax treatment of income generated by intangible property used within Massachusetts by a foreign corporation. To the extent that Geoffrey was uncertain about its obligation to pay corporate excise taxes or disagreed with the department's position as set forth in the directive, there is no evidence in the record that it sought a letter ruling or other guidance from the department on these matters. See 830 Code Mass. Regs. § 62C.3.2 (1993) (describing purposes of and procedures for letter rulings). See also 830 Code Mass. Regs. § 63.39.1(9) (1993) (setting forth procedures for requesting nexus determination from commissioner). Contrary to Geoffrey's assertion, the issue whether TRUMI was entitled to deduct from its own taxes the royalty payments made to Geoffrey was unrelated to

the issue whether Geoffrey was obligated to pay corporate excises on its Massachusetts income. We conclude that Geoffrey has not demonstrated that it acted with reasonable cause in failing to file corporate excise returns and in failing to pay taxes pursuant to G. L. c. 63, § 39. Therefore, the penalties imposed on Geoffrey by the board were properly assessed.

Decision of the Appellate Tax Board affirmed.

APPENDIX B

Supreme Judicial Court for the
Commonwealth of Massachusetts
John Adams Courthouse
One Pemberton Square, Suite 1400,
Boston, Massachusetts 02108-1724
Telephone 617-557-1020, Fax 617-557-1145

Dated: November 21, 2007

Paul H. Frankel
Morrison & Foerster LLP
1290 Avenue of the Americas
New York, NY 10104

RE: No. DAR-16548

GEOFFREY, INC.
vs.
COMMISSIONER OF REVENUE

Appellate Tax Board No. C271816
A.C. No. 2007-P-1559

NOTICE OF ALLOWANCE OF APPLICATION FOR DIRECT APPELLATE REVIEW

Notice is hereby given that on 11/21/07, the above-captioned Application for Direct Appellate Review was allowed.

Upon receipt of the case papers from the Appeals Court, notice will be sent to counsel indicating the new S.J.C. docket number, the number of briefs/

appendices transferred, and the Sitting to which the case is assigned for argument before the full bench.

Susan Mellen, Clerk

To: Maxwell D. Solet, Esquire
Anne P. Hristov, Esquire
Thomas A. Barnico, A.A.G.
Paul H. Frankel

APPENDIX C

[SEAL]

THE COMMONWEALTH OF MASSACHUSETTS
Appellate Tax Board
100 CAMBRIDGE STREET
SUITE 200
Boston, Massachusetts 02114

(617) 727-3100
(617) 727-6234 Fax

Docket No. C271816

GEOFFREY, INC.,
Appellant.

COMMISSIONER OF REVENUE,
Appellee.

DECISION

The decision is for the appellee. Chairman Hammond took no part in the consideration or decision of this appeal.

APPELLATE TAX BOARD

By: /s/ Frank J. Scharaffa Commissioner
Nancy T. Egan Commissioner
James D. Rose Commissioner
Thomas J. Mulhern Commissioner

Attest: /s/ Michelle Tallent Asst. Clerk

Date: JUL 24 2007
(Seal)

COMMONWEALTH OF MASSACHUSETTS
APPELLATE TAX BOARD

GEOFFREY, INC. **v.** **COMMISSIONER OF REVENUE**

Docket No. C271816

Promulgated:
July 24, 2007

This is an appeal under the formal procedure pursuant to G.L. c. 58A, § 7 and G.L. c. 62C, § 39 from the refusal of the appellee Commissioner of Revenue ("appellee" or "Commissioner") to grant an abatement of corporate excises assessed against appellant Geoffrey, Inc. ("Geoffrey") under G.L. c. 63, § 39 for the taxable years ending January 31, 1997 through January 31, 2001.

Commissioner Gorton heard this appeal. With Commissioner Gorton materially participating in the deliberations of this appeal[1] Commissioners Scharaffa, Egan, Rose and Mulhern joined in the decision for the appellee, adopting the

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[1] On September 11, 2006, Commissioner Gorton was sworn as a temporary member of the Appellate Tax Board pursuant to G.L. c. 58A, § 1, his status as a member of the Board having terminated on that date with the appointment and qualification of his successor. *See* G.L. c. 30, § 8. Commissioner Gorton's material participation in the deliberations of these appeals included, *inter alia*, drafting and distributing proposed findings of fact supplying a report on the evidence and his observations as to witness credibility. He also made oral presentations of his recommendations to the Board members.

recommendations of the hearing officer. Chairman Hammond took no part in the consideration or decision of this appeal.

These findings of fact and report are made on the Appellate Tax Board's own motion under G.L. c. 58A, § 13 and 831 CMR 1.32 and are promulgated simultaneously with its decision.

Paul H. Frankel, Esq., *Irwin M. Slomka,* Esq., and *Maxwell D. Solet,* Esq. for the appellants.

Thomas W. Hammond, Esq., *Anne P. Hristov,* Esq., and *Patricia M. Good,* Esq. for the appellee.

FINDINGS OF FACT AND REPORT

Geoffrey challenged the validity of a corporate excise deficiency assessment made by the appellee for the taxable years ending January 31, 1997 through January 31, 2001 inclusive ("years at issue"). Geoffrey's claim rested principally on the Commerce Clause of the United States Constitution (U.S. Const. art. I, § 8, cl. 3 (the "Commerce Clause"). On the basis of the parties' Agreed Statements of Facts and the testimony and exhibits presented at trial, the Board made the following findings of fact, relying on and adopting the recommendations of the hearing officer as to issues of witness credibility.

During the appellee's audit of Geoffrey's affiliated entity, Toys "R" Us-Mass, Inc. ("TRUMI"), the Commissioner discovered that Geoffrey received royalty income from TRUMI for the licensure of

Geoffrey's trademarks, trade names, and service marks for TRUMI's use in its retail business activities in Massachusetts. Taxation of this royalty income, and separate royalty income paid to Geoffrey by Baby Superstore, Inc., which was also licensed to use Geoffrey's intellectual property in Massachusetts, supplied the basis for the assessments at issue.

On October 2, 2002, the Commissioner issued a Notice of Failure to File Return to Geoffrey for the taxable years spanning February 1, 1996 through January 31, 2001. On or about October 15, 2002, Geoffrey supplied to the Audit Division of the Department of Revenue ("DOR") unsigned, pro-forma Massachusetts Foreign Business or Manufacturing Corporation Excise Returns ("Returns") for the years at issue. A Notice of Intention to Assess was issued on December 14, 2002; a revised notice followed on December 23, 2002.

On January 28, 2003, the Commissioner issued a Notice of Assessment to Geoffrey for the years at issue, in the amount of $1,692,568 in corporate excise plus statutory additions.[2] Appellee apportioned Geoffrey's royalty income to Massachusetts based on a sales factor alone, because its property and payroll factors were each less than 3.33% of its taxable net income. The sales factor was computed on the basis of

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[2] The parties' Second Supplemental Stipulation of Facts corrected that the amount of tax in dispute is actually $1,257,793.

the ratio of Geoffrey's royalty income from Massachusetts retail operations, to its royalty and interest income from all sources.

Geoffrey filed an Application for Abatement on February 25, 2003. The Commissioner's Notice of Abatement Determination, denying the requested abatement, was issued on September 19, 2003. Geoffrey filed a Petition Under Formal Procedure with the Appellate Tax Board ("Board"), commencing the instant appeal, on November 18, 2003. The foregoing facts establish the Board's jurisdiction over this appeal.

Geoffrey presented three witnesses at trial: Mr. Peter Weiss, the Senior Vice President for Taxes of Toys "R" Us, Inc., and an officer and director of Geoffrey; Professor Richard D. Pomp of the University of Connecticut Law School; and attorney Paul Fields of the New York law firm of Darby and Darby. Mr. Weiss testified about the business structure of the Toys "R" Us family of corporations. Professor Pomp offered an opinion – based on economic policy considerations – regarding the interpretation of the "substantial nexus" requirement which governs state taxation of businesses engaged in interstate commerce. Mr. Fields, an expert in the field of intellectual property who had served as outside counsel to Geoffrey and other Toys "R" Us entities on trademark and trade name issues, described efforts to protect Geoffrey's interests in its trademarks, trade names, and service marks. The factual testimony, which was credible and uncontradicted, served to

supplement the stipulated facts, and was relied on by the hearing officer and the Board to flesh out the relevant circumstances in a number of details.

The operative facts are undisputed. The corporate parent of both Geoffrey and TRUMI was Toys "R" Us, Inc., which was a publicly held company during the years at issue. It held shares in the various Toys "R" Us operating subsidiaries and provided management and support services to the stores and companies. TRUMI, a first-tier subsidiary of Toys "R" Us, Inc., operated retail toy and children's clothing stores in Massachusetts. During the years at issue, TRUMI operated a total of 26 Toys "R" Us and Kids "R" Us retail stores at locations throughout the Commonwealth. TRUMI filed Massachusetts corporate excise tax returns on a single-entity basis.

TRU, Inc., a holding company, was a subsidiary of Toys "R" Us, Inc. and the parent of Geoffrey. Geoffrey was incorporated in Delaware on January 28, 1984. Effective August 1, 1984, Toys "R" Us, Inc. transferred trademarks, trade names, and service marks (the "Trademarks") to Geoffrey, including the "Toys 'R' Us" and "Kids 'R' Us" trademarks in exchange for stock. The Trademarks acquired by Geoffrey also included the "Geoffrey" giraffe character that is the logo for Toys "R" Us.

Arthur Andersen and Company's Valuation Services Group was engaged in 1991 to ascertain a fair market value royalty rate for the Trademarks owned by Geoffrey. In Arthur Andersen's opinion, the

fair market value of the intellectual property owned by Geoffrey was $1.5 billion. Arthur Andersen deemed 3 per cent of net sales revenue to be the fair market value royalty rate for the use of the Toys "R" Us Trademarks, and 2 per cent of net sales revenue to be the fair market value royalty rate for the use of the Kids "R" Us Trademarks. A subsequent transfer pricing study, including a valuation of a royalty rate for licensure of the Trademarks, was performed by Ernst and Young. The Ernst and Young study supported the Arthur Andersen valuation findings.

Geoffrey's business activities entailed entering into licensing agreements which allowed the various Toys 'R' Us, Inc. operating companies to use the Trademarks in support of their retail operations. These agreements were renegotiated following Arthur Andersen's valuation study. Geoffrey's licensing agreement with TRUMI, entered into on May 3, 1992, permitted the use of the subject Trademarks solely in Massachusetts. Geoffrey had the right to review guides used in the creation of advertisements featuring the Trademarks, customer complaint statistics, and private label product testing reports. Geoffrey also had the right to see product samples.

Pursuant to the licensing agreement, Geoffrey received a royalty of 2 per cent of TRUMI's net sales income at Kids "R" Us stores in Massachusetts for the use of the Kids "R" Us Trademarks, and a royalty of 3 per cent of TRUMI's net sales at Toys "R" Us stores located in Massachusetts for the use of the Toys "R" Us Trademarks. Signing for Geoffrey was Howard

Simon, President of Geoffrey, whose offices were situated in Wilmington, Delaware. Jonathon Friedman, an officer of TRUMI, signed for the licensee. His offices were in New Jersey. The agreement was made subject to the laws of Delaware.[3] Geoffrey had no Massachusetts employees or offices and owned no tangible property, real or personal, in Massachusetts during the years at issue.

Geoffrey also licensed Trademarks for the use of "Babies 'R' Us", a division of Baby Superstore, Inc. Babies "R" Us operated stores in three Massachusetts locations during the years at issue. The licensing agreement involving Babies "R" Us, signed in February of 1997, set a royalty rate of 1 per cent of net sales revenue for the fiscal year 1996, 1.5 per cent of net sales for the fiscal year 1997, and 2 per cent of net sales for all years remaining in the duration of the agreement.

In an example of their use in Massachusetts, physical manifestations of the Trademarks would be held out to the public on signage, store displays, and product packaging at the Massachusetts stores operated by TRUMI. The Trademarks were intended to represent to consumers that goods and services sold by licensees were of a certain level of quality. Geoffrey's rights to its Trademarks were

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[3] For the first four years at issue, appellant was based in Wilmington, Delaware. On January 1, 2000, Geoffrey moved its offices and employees to Paramus, New Jersey.

strengthened by their use, including their use by Toys "R" Us, Kids "R" Us, and Babies "R" Us stores in Massachusetts. Geoffrey had access to the Massachusetts courts, and federal courts located in Massachusetts, to protect its interests in its Trademarks and its entitlement to royalty payments under the licensing agreements.

The licensing agreements gave Geoffrey considerable control over how the Trademarks were put to use in Massachusetts, in the interest of preserving their reputation for quality and value. At § 6.3 of the 1992 TRUMI license agreement, Geoffrey retained the right to review product samples and specifications, signs, labels, tags, packaging material, advertising and sales promotion materials, bills, catalogs, pamphlets or the like, which displayed any Trademark information. At § 7.2, TRUMI agreed to comply with Geoffrey's instructions so as to obviate the possibility that the Trademarks might become generic terms, which might adversely affect Geoffrey's interests in its Trademarks.[4]

Pursuant to a Quality Control, Legal And Treasury Service Agreement dated February 6, 1996, Toys "R" Us, Inc. provided services to Geoffrey to assist with quality control issues related to the Trademarks. Toys "R" Us, Inc. dedicated the services of an intellectual property specialist, Ms. Ellen

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[4] Similar provisions appear in Geoffrey's 1997 license agreement with Baby Superstore, Inc.

Storch, to the task of protecting Geoffrey's assets. Toys "R" Us, Inc. also employed the regional and district managers with responsibilities for Massachusetts stores, who could monitor use of the Trademarks in Massachusetts and would bring any problems in stores, *e.g.* issues related to cleanliness, to the attention of the appropriate officials. Toys "R" Us, Inc. produced reports, explaining the results of its quality control activities, and copies were also supplied to Geoffrey. For its services Toys "R" Us, Inc. was paid $300,000 a year.[5]

On January 1, 2000, Geoffrey changed its principal place of business from Wilmington, Delaware to Paramus, New Jersey. Moreover, Toys "R" Us, Inc. entered into a Management Service Agreement with Geoffrey, and certain Toys "R" Us, Inc. employees became employees of Geoffrey, also on January 1, 2000. Toys "R" Us, Inc. continued to make Ms. Starch's services available under the Management Service Agreement to protect Geoffrey's interest in its Trademarks.

Geoffrey entered into an Accounting and Management Services Agreement with Simon, Master, and Sidlow, a Delaware accounting firm, on January 8, 1993. Geoffrey also obtained additional services from several outside firms, including Mr. Fields' law firm, which provided legal services to

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[5] Mr. Weiss attended to quality control issues on behalf of Geoffrey.

Geoffrey to protect its ownership interests and the value of the Trademarks. The Trademarks were registered with the United States Patent and Trademark Office. The Darby law firm, acting on information from Geoffrey and third parties, kept vigilance against any infringements on the Trademarks owned by Geoffrey. Legal services included preparation of "cease and desist" letters to potential infringers. Trademark infringement claims might have led to settlement agreements or litigation by Geoffrey.

The testimony established that Geoffrey acted to protect its Trademarks against claimed infringement by a Massachusetts-based business, "GunsAreUs.com." The claim led to an infringement action in the Federal District Court for the Southern District of New York. The claimed infringer eventually changed its name.

Geoffrey received the following amounts of royalty income with respect to retail stores located in Massachusetts:

Taxable Year Ending:	Royalty Income Received
2/1/97	$5,928,567
1/31/98	$6,554,625
1/30/99	$6,628,656
1/29/00	$7,117,981
2/3/01	$7,423,420

On the basis of the foregoing, the Board found and ruled that Geoffrey's business activities gave it "substantial nexus" with Massachusetts. In reaching this conclusion, the Board agreed that Geoffrey neither owned nor leased real property in Massachusetts. Moreover, the Board found that no employee of Geoffrey was situated in Massachusetts during the years at issue. Nevertheless, Geoffrey purposefully sought to reap economic benefits from the Massachusetts retail marketplace by licensing its assets for use in Massachusetts by TRUMI and Baby Superstore, Inc. The Trademarks were used extensively by Toys "R" Us, Kids "R" Us, and Babies "R" Us stores in Massachusetts. The receipt of substantial royalty income over the course of the years at issue represented the realization of the desired economic benefits from Massachusetts.

Moreover, Geoffrey reserved the ability to regulate the use of its Trademarks in Massachusetts, having rights of approval over promotional activities, product standards, and store conditions which might damage the value of the Trademarks. Finally, Massachusetts afforded rights and protections to Geoffrey in connection with the use of the Trademarks here, including recourse to the courts of the Commonwealth to address issues of trademark infringement and compliance with the terms of the licensing agreements. These facts supported a finding of "substantial nexus," so as to validate the disputed tax assessment.

Accordingly, for all of the foregoing reasons, the Board issued a decision for the appellee in this appeal.[6]

OPINION

The principal issue on this appeal was whether the Commerce Clause requires that a foreign corporation have a "physical presence" in a state in order to support the imposition of that state's income-based corporate excise[7]. Geoffrey also challenged the application of the statutory apportionment formula of G.L. c. 63, § 38 on the ground that it resulted in taxation of extraterritorial values.

The Board first addressed the relevant statutory scheme and Geoffrey's statutory arguments. The assessment arose by operation of G.L. c. 63, § 39, which provides that "every foreign corporation, exercising its charter, or qualified to do business or

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[6] The hearing officer's participation in the deliberations and decision of this case, which included the preparation of recommended findings of fact and rulings of law and consultations with Board members, satisfied the requirements of ***Bayer v. Commissioner of Revenue***, 436 Mass. 302 (2002), as interpreted in the Board's decision in ***Mayflower Emerald Square, LLC v. Board of Assessors of the Town of North Attleborough***, ATB Findings of Fact and Report 2007-421, 517-18.

[7] The tax imposed under G.L. c. 63 is measured on the basis of net income and corporate net worth. *See* G.L. c. 63, § 39(a).

actually doing business in the commonwealth, or owning or using any part or all its capital, plant or any other property in commonwealth, shall pay, on account of each taxable year, the excise provided in subsection (a) or (b) of this section. . . ." The legislative intent of this section is amplified at G.L. c. 63, § 39(3), where it is stated that

> It is the purpose of this section to require the payment of this excise to the commonwealth by foreign corporations for the enjoyment under the protection of the laws of the commonwealth, of the powers, rights, privileges, and immunities derived by reason of the corporate form of existence and operation.

The Appeals Court explained the statutory apportionment methodology in its opinion in ***Dana Lease Finance Corp. v. Commissioner of Revenue,*** 53 Mass. App. Ct. 840, 841 n.1 (2002):

> For corporations having income from business which is taxable both here and another [sic] States, income is apportioned to Massachusetts by multiplying taxable net income by a fraction called the "income apportionment percentage", *see* G.L. c. 63, §§ 30(9), 38(c). This uses the sum of three factors, "property," "payroll," and "sales" in the numerator; if a factor is "insignificant," G.L. c. 63 § 38(g), it is eliminated and the denominator of the fraction is reduced. . . .

Accordingly, given that Geoffrey had no property and payroll in the commonwealth, these two apportionment factors were inapplicable in the relevant calculation, and Geoffrey's net income was apportioned on the basis of a sales factor-derived percentage. *See* G.L. c. 63 § 38(g).[8]

Geoffrey contested the tax with the argument that it made no sales in Massachusetts, and, given its lack of physical presence, its income-producing activities occurred out-of-state. The statute provides that

> Sales other than sales of tangible personal property, are in this commonwealth, if 1. the income-producing activity is performed in this commonwealth; or 2. the income-producing activity is performed both in and outside this commonwealth and a greater proportion of this income-producing activity is performed in this commonwealth than in any other state, based on costs of performance.

G.L. c. 63, § 38(f)[9].

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[8] According to the Audit Narrative, offered jointly by the parties as a stipulated exhibit, DOR simply accepted the numbers for the property and payroll factors that were reflected in Geoffrey's pro forma returns.

[9] The record does not indicate that Geoffrey's royalties from Baby Superstore, Inc. were greater in "any other one state" than in Massachusetts. *See* ***Interface Group-Nevada, Inc. v. Commissioner of Revenue***, ATB Findings of Fact and Report 2000-324, 359-60.

830 CMR 63.38.1(9(d)(3)(c) addresses the sourcing of gross receipts from the licensing of intangible property, like Geoffrey's Trademarks:

> Gross receipts from the licensing of intangible property are attributable to Massachusetts if the property is used by the . . . licensee solely in Massachusetts. If the . . . licensee uses the intangible property in more than one state, the gross receipts from licensing . . . are attributable to Massachusetts if the use of property by the . . . licensee in Massachusetts exceeds its use of the property in any other one state.

The statute, interpreted in light of this regulation, would place the income-producing activity giving rise to the royalty income at issue in Massachusetts on the instant record. TRUMI, the licensee, used Geoffrey's trademarks exclusively in Massachusetts. TRUMI incurred an obligation to pay Geoffrey royalties in agreed percentages based on sales occurring in TRUMI's Massachusetts retail stores. Because Geoffrey's income arose in connection with Massachusetts sales made on the strength of its Trademarks, the relevant income-producing activity was treated as taking place in the commonwealth.

Nevertheless, Geoffrey challenged the rule of 830 CMR 63.38.1(9(d)(3)(c) as being inconsistent with statute, arguing that the statute looked only to *Geoffrey's* activities, none of which formally transpired in Massachusetts. However, "[r]egulations issued by an agency are presumptively valid so long

as they are authorized by the enabling statute and do not violate any other statute or the Federal or State constitution." ***Cohen v. Bd. of Water Commissioners, Fire Dist. No. 1, South Hadley,*** 411 Mass. 744, 749 (1992). As the Supreme Judicial Court has held, "review of the validity of a regulation promulgated by a State agency is guided by the established principle that '[r]egulations are not to be declared void unless their provisions cannot by any reasonable construction be interpreted in harmony with the legislative mandate.'" ***Smith v. Commissioner of Transitional Assistance,*** 431 Mass. 638, 646 (2000) (Citations omitted.)

Geoffrey failed to establish inconsistency between regulation and statute. *Cf.* ***Duarte v. Commissioner of Revenue,*** ATB Findings of Fact and Report 2006-490, 515-16. Nothing in G.L. c. 63, § 38(f) requires so blinkered a view of the relevant income-producing activity as to disregard the important uses to which Geoffrey's Trademarks were put in Massachusetts. In ***Allied Building Credits, Inc. v. State Tax Commission,*** 344 Mass. 503, 507 (1962), the Supreme Judicial Court held that G.L. c. 63 "did not in terms restrict the meaning of assets 'employed in any business within the commonwealth' to assets physically or legally situated here." (Citation omitted.) The taxpayer in ***Allied Building*** bought installment notes made to sellers of lumber, carpets, furniture, and heating and plumbing supplies by the buyers of these products. Though the taxpayer argued that its intangible assets should be

sourced to its state of domicile, California, the Court held that the intangibles were appropriately considered in arriving at the amount of corporate excise payable to the Commonwealth. *Id.* The Court explained that "[l]egal situs of intangibles is, to a degree at least, determinable in light of the purpose of the determination." *Id.* at 508. The Court concluded that "[a] State, in imposing excises, may look to property beyond its borders to get the true value of things within it." ***Id.***

With a profit-seeking intent, Geoffrey licensed its intangibles for use in this state, and earned a share of the proceeds as sales were made at TRUMI's and Baby Superstore's Massachusetts retail locations. The licensing agreements recognized that the value of Geoffrey's Trademarks contributed to retail sale transactions at Toys "R" Us, Kids "R" Us, and Babies "R" Us stores in Massachusetts. "The findings show that in such a business as [Geoffrey's] the out-of-State intangibles may have very important uses within the Commonwealth." *Cf.* ***id.*** Given the intended use of its property to facilitate retail sales in Massachusetts, Geoffrey's assertion that its income-producing activity occurred entirely out-of-state is strained and formalistic.

Furthermore, the Supreme Judicial Court upheld the application of 830 CMR 63.38.1(9[)](d)(3)(c) in ***Boston Professional Hockey Ass'n, Inc. v. Commissioner of Revenue,*** 443 Mass. 276, 282-283, 296-98 (2005). Geoffrey failed to persuade that physical presence or the formal situs of intangible

assets in Massachusetts was a prerequisite to finding income-producing activity within the meaning of the corporate excise statute.[10]

Finally, Geoffrey failed to establish it was entitled to use an alternative method of apportionment, *e.g.* by including a property factor in the apportionment formula used to arrive at the percentage of net income which was attributable to Massachusetts. Geoffrey cited G.L. c. 63, § 42 in arguing that apportionment pursuant to G.L. c. 63, § 38 was "not reasonably adapted to approximate the net income derived from business carried on within this commonwealth. . . ."[11] Yet, beyond bare assertions that its income-producing activities occurred out-of-state, Geoffrey failed to satisfy its burden of showing "by 'clear and cogent evidence' that the income attributed to the Commonwealth is in fact 'out of all appropriate proportion to the business transacted' here or has 'led to a grossly distorted result.'" ***Gillette Co. v. Commissioner of Revenue***,

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[10] Geoffrey also argued that passage of Stat. 2004, c. 262, § 42, which made explicit that use of an intangible asset in Massachusetts qualifies as "income producing activity" for purposes of G.L. c. 63, § 38(f), indicates that the law was otherwise for the years at issue. The Board agreed with the contemporaneous view of TIR 04-22 IV. that "the amendment restates and clarifies existing law in manner consistent with the Commissioner's prior interpretation and practice." *Citing* 830 CMR 63.38.1(9(d)(3)(c).

[11] There is no indication on the record that Geoffrey actually applied to the Commissioner utilizing the G.L. c. 63, § 42 procedure.

425 Mass. 670, 679 (1997) (Citations omitted.) "[B]lanket assertions" of the sort Geoffrey relied on are not sufficient to warrant application of G.L. c. 63, § 42. *See* ***id.***

Geoffrey's constitutional claim relied on a broad reading of the decision of the United States Supreme Court in ***Quill Corp. v. North Dakota,*** 504 U.S. 298, 305 (1992), to argue that the Commerce Clause precluded application of the corporate excise given its lack of physical presence in Massachusetts. ***Quill*** reaffirmed the prior decision of the Court in ***National Bellas Hess, Inc. v. Department of Revenue of Illinois,*** 386 U.S. 753 (1967), which held that a taxpayer's physical presence in a state was necessary to square that state's imposition of a sales or use tax with the Commerce Clause. While this constitutional question may have been open at the time of trial, it has since been resolved by the Board. In ***Capitol One Bank and Capitol One F.S.B. v. Commissioner of Revenue,*** ATB Findings of Fact and Report 2007-544, 565, the Board held that "neither . . . Supreme Court nor Massachusetts precedent supports the proposition that physical presence is required to impose an income-based tax. . . ." Indeed, as ***Capitol One*** emphasizes, "Massachusetts has recognized the Supreme Court's careful limitation of ***Quill*** to the sales and use tax context." ***Id.*** at 2007-565.

Capitol One settled that the authority governing Geoffrey's Commerce Clause claim is ***Complete Auto Transit, Inc. v. Brady,*** 430 U.S.

274, 279 (1977), which authorized state taxation of "a company engaged in purely interstate commerce provided that the tax: '[1] is applied to an activity with a substantial nexus with the taxing state, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, [4] and is fairly related to the services provided by the State.'" ATB Findings of Fact and Report 2007-560. Focusing on the first prong of the ***Complete Auto Transit*** test, which is the crux of Geoffrey's claim, the Board observed that "'[s]ubstantial nexus' comprises contacts of varied character and not merely those of a physical nature." ***Id.*** at 566. The Board agreed with the Supreme Court of Appeals of West Virginia, which held that "[r]ather than a physical presence standard, this Court believes that a significant economic presence test is a better indicator of whether substantial nexus exists for Commerce Clause purposes." ***Tax Commissioner of West Virginia v. MBNA America Bank, N.A.,*** 640 S.E.2d 226, 234 (2006). "[T]he [West Virginia] court, despite finding that the taxpayer had no real or tangible personal property or real estate located in the state, had 'no trouble concluding that MBNA's systematic and continuous business activity in this State produced significant gross receipts attributable to its West Virginia customers which indicate a significant economic presence sufficient to meet the substantial nexus prong of ***Complete Auto***.'" ATB Findings of Fact and Report at 2007-567, *quoting* 640 S.E.2d at 236.

Capitol One also relied on other cases in which a company was deemed subject to an income-based tax based "solely on the presence of [intangible] trademark assets within the taxing jurisdiction." ATB Findings of Fact and Report 2007-569, *citing, e.g.*, ***Geoffrey, Inc. v. South Carolina Tax Commission,*** 437 S.E.2d 13 (S.C. 1993). In a case involving a similar claim by the same taxpayer, the South Carolina Supreme Court held that "by licensing intangibles for use in this state and deriving income from their use here, Geoffrey ha[d] a 'substantial nexus' with South Carolina." ***Geoffrey,*** 437 S.E.2d at 18. In ***Lanco, Inc. v. Director, Division of Taxation,*** 879 A.2d 1234, 1235 (N.J. Super. Ct. App. Div. 2005), *aff'd*, 908 A.2d 176 (N.J. 2006), the Appellate Division of the New Jersey Superior Court upheld an income-based tax on a foreign trademark holding company with "no physical presence in the state [which] derive[d] income from a New Jersey source pursuant only to a license agreement with another corporation that conducts a retail business" in the state. In affirming the Appellate Division, the New Jersey Supreme Court held that "[i] **Quill**, the court did not attempt to equate the substantial-nexus requirement with a universal physical-presence requirement." 908 A.2d at 177. *See also* ***Secretary, Department of Revenue v. Gap (Apparel), Inc.,*** 886 S.2d 459, 462 (La. Ct. App. 2004) ("While Apparel may not have a physical presence in Louisiana, its intangible property clearly has a connection with Louisiana . . . [and] it is clear that the marks licensed by Apparel have been used in Louisiana in such a way as to become an integral part

of the licensees' business in this state.") *Accord* ***Kmart Properties, Inc. v. Taxation and Revenue Department,*** 139 N.M. 177, 185 (N.M. Ct. App 2001); ***A&F Trademark, Inc. v. Tolson,*** 605 S.E.2d 187, 195 (N.C. Ct. App. 2004).

The Board held in ***Capitol One*** "consistent with the overwhelming weight of authority from the Supreme Court and those jurisdictions that have addressed the question, that the physical presence requirement in ***Quill*** is not applicable to an income based excise. . . ." ATB Findings of Fact and Report at 2007-572-573. Instead, as the Board observed, "the use of Capitol One's intangible property – the Capitol One trademark on the cards – within the Massachusetts economic market to generate substantial revenue further supports the Board's ruling that there was substantial nexus."[12]

As in ***Capitol One,*** Geoffrey here purposefully "derived substantial economic gain from the

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[12] The use of an "economic presence" criterion to apply the "substantial nexus" requirement also accords with the "well established" rule in the field of taxation "'that the substance should prevail over form.'" *See generally* ***Spirit of Yankee, Inc. v. Commissioner of Revenue,*** ATB Findings of Fact and Report 1998-723, 733 (Citations omitted.) Although intangibles definitionally lack a physical situs, the effective presence of the Trademarks in Massachusetts is substantiated every day by Massachusetts consumers' purchase decisions in reliance on the assurances of product quality and value represented by the name "Toys 'R' Us." *Cf.* ***Allied Building Credits,*** 344 Mass. at 507-08.

Massachusetts market through a sophisticated marketing campaign" that harnessed the value of its intangibles to induce Massachusetts customers to make purchases from which it profited. *Cf.* ATB Findings of Fact and Report at 2007-573. The good will represented by Geoffrey's Trademarks, which was carefully guarded, and the assurance of product quality they were intended to give, enabled transactions to occur in Massachusetts from which Geoffrey obtained substantial royalty income.[13] The Board found compelling the fact that Geoffrey derived over $33 million in royalties from the Massachusetts consumer marketplace during the years at issue, in ruling that the "substantial nexus" prong of ***Complete Auto Transit*** was satisfied by its economic presence in Massachusetts.

Geoffrey's final argument seeks abatement of penalties for underpayment of tax and late filing, pursuant to G.L. c. 62C, § 33(a). It contends that justifiable reliance on the ***Quill*** decision supplied reasonable cause for its decision not to file Massachusetts tax returns or pay Massachusetts corporate excise, given its lack of physical presence.

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[13] As in ***Capitol One,*** the Board found that Geoffrey's expert witness's "opinions from an economic and policy perspective" to be unpersuasive in resolving the statutory and constitutional questions presented. ATB Findings of Fact and Report at 2007-574. The Board's task is to adhere to the policy choices made by the legislature and follow the precedents set by the courts.

However, ***Quill*** addresses sales and use taxation, not an income-based corporate excise, a fact the Supreme Judicial Court stressed in ***Truck Renting and Leasing Assn v. Commissioner of Revenue,*** 433 Mass. 733, 740 n.13 (2001) ("In ***Quill*** the Court upheld a 'physical-presence requirement' before a State, consistent with the commerce clause, could subject an out-of-State vendor to a use or sales tax. *The Court did not extend this rule to other types of tax.*") (Emphasis added.) Geoffrey's efforts to have the rule of ***Quill*** extended beyond the sales and use tax context did not justify its failure to comply with the taxing laws of the Commonwealth, which are entitled to a presumption of constitutionality. *See, e.g.*, ***Kienzler v. Dalkon Shield Claimants Trust,*** 426 Mass. 87, 89 (1997). "Reasonable cause . . . 'should not be read to include a clearly erroneous view of the law, stubbornly adhered to after investigation should have disclosed the error.'" ***United States v. Bell Credit Union,*** 860 F.2d 365, 372 (10th Cir. 1988), *quoting* ***United States v. Sterling Nat'l Bank & Trust. Co.,*** 494 F.2d 919, 925 (2nd Cir. 1974) (Friendly, J., dissenting).

In conclusion, the Board found that the disputed assessment was authorized by the corporate excise statute, and did not transgress the constitutional limits on the exercise of a state's taxing power. Moreover, Geoffrey did not demonstrate that it acted with reasonable cause in its failure to file returns or

pay taxes. The Board decided this appeal for the appellee.

THE APPELLATE TAX BOARD

By: /s/ Frank J. Scharaffa
Frank J. Scharaffa,
Commissioner

A true copy,

Attest: /s/ Michelle Tallent
Assistant Clerk of the Board

APPENDIX D

GENERAL LAWS OF THE COMMONWEALTH OF MASSACHUSETTS, 1932, CHAPTER 63 TAXATION OF CORPORATIONS, Domestic Corporations.

Sec. 38. Allocation of net income.

The commissioner shall determine the part of the net income of a domestic business corporation or of a foreign corporation derived from business carried on within the commonwealth as follows:

(a)

Net income as defined in section thirty of this chapter adjusted as follows shall constitute taxable net income:

(1)

Ninety-five per cent of dividends, exclusive of distributions in liquidation, included therein shall be deducted other than dividends from or on account of the ownership of:

(i)

shares in a corporate trust, as defined in section one of chapter sixty-two, engaged in business in the commonwealth, or

(ii)

deemed distributions and actual distributions, except actual distributions out of previously taxed income, from a DISC which is not a wholly-owned DISC, or

(iii)

any class of stock, if the corporation owns less than fifteen percent of the voting stock of the corporation paying such dividend.

(2)

Long-term capital gains realized and long-term capital losses sustained from the sale or exchange of intangible property affected under the provisions of the Federal Internal Revenue Code, as amended and in effect for taxable years ended on or before December thirty-first, nineteen hundred and sixty-two, shall not be included in any part therein.

(b)

If the corporation does not have income from business activity which is taxable in another state, the whole of its taxable net income, determined under the provisions of subsection *(a)*, shall be allocated to this commonwealth. For purposes of this section, a corporation is taxable in another state if (1) in that state such corporation is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax, or (2) that state has jurisdiction to subject such corporation to a net income tax regardless of whether, in fact, the state does or does not.

* * *

(c)

If a corporation, other than a defense corporation as described in subsection *(k)*, a manufacturing corporation as described in subsection *(l)*, or a mutual fund service corporation to the extent of its mutual fund sales as described in subsection *(m)*, has income from business activity which is taxable both within and without this commonwealth, its taxable net income, as determined under the provisions of subsection *(a)*, shall be apportioned to this commonwealth by multiplying said taxable net income by a fraction, the numerator of which is the property factor plus the payroll factor plus twice times the sales factor, and the denominator of which is four.

(d)

The property factor is a fraction, the numerator of which is the average value of the corporation's real and tangible personal property owned or rented and used in this commonwealth during the taxable year and the denominator of which is the average value of all the corporation's real and tangible personal property owned or rented and used during the taxable year. Property owned by the corporation shall be valued at its original cost. Property rented by the corporation shall be valued at eight times the net annual rental rate, provided such rate reflects the fair rental value of the property as of the date of the rental agreement. Net

annual rental rate is the annual rental rate paid by the corporation less any annual rental rate received by the corporation from sub-rentals.

The average value of property shall be determined by averaging the values at the beginning and the end of the taxable year, but the commissioner may require the averaging of monthly values during the taxable year if reasonably required to reflect properly the average value of the corporation's property. For the purpose of this subsection leaseholds and leasehold improvements, whether located within or without the commonwealth, shall be included within the meaning of real and tangible personal property.

(e)

The payroll factor is a fraction, the numerator of which is the total amount paid in this commonwealth during the taxable year by the corporation for compensation, and the denominator of which is the total compensation paid everywhere during the taxable year.

The payroll factor for a manufacturing corporation or a business corporation engaged primarily in research and development, which has been deemed to be such under the provisions of section thirty-eight C or forty-two B, is a fraction the numerator of which is the lesser of the following amounts: –

(i)

the total amount paid in this commonwealth by the corporation for compensation during the taxable year; or

(ii)

the greater of (a) the total amount paid in this commonwealth by the corporation for compensation during the taxable year ended in the year nineteen hundred and seventy-two increased by five per cent per year for each taxable year subsequent to the taxable year ended in nineteen hundred and seventy-two; or (b)

(1) in taxable years ending on or after December thirty-first, nineteen hundred and eighty-two and before December thirty-first, nineteen hundred and eighty-three, seventy-five per cent of the total amount paid in this commonwealth by the corporation for compensation, (2) in taxable year ending on or after December thirty-first, nineteen hundred and eighty-three and before December thirty-first, nineteen hundred and eighty-four, eighty per cent of the total amount paid in this commonwealth by the corporation for compensation, (3) in taxable year ending on or after December thirty-first, nineteen hundred and eighty-four, and before December thirty-first, nineteen hundred and eighty-five, ninety per cent of the total amount paid in this commonwealth by the corporation for compensation, and (4) in taxable years ending on or after December

thirty-first, nineteen hundred and eighty-five and thereafter, the total amount paid in this commonwealth by the corporation for compensation.

The denominator of the payroll factor for such corporation shall be adjusted for compensation paid in this commonwealth to include in total compensation paid everywhere only that amount for compensation paid in this commonwealth which is equal to the amount included in the numerator as determined under *(i)* and *(ii)* in this subsection.

Notwithstanding the provisions of this subsection, a corporation shall be eligible for the credit provided for in section thirty-one C. For the purposes of determination of the credit under section thirty-one C, the total amount of compensation paid in this commonwealth by the corporation for the taxable year shall be allowed.

As used in this subsection, "compensation" means wages, salaries, commissions, and any other form of remuneration paid to employees for personal services. Compensation is paid in this commonwealth if:

1.

the employee's service is performed entirely within this commonwealth; or

2.

the employee's service is performed both within and without this commonwealth, but the service performed without this commonwealth is incidental to the employee's service within this commonwealth; or

3.

some of the service is performed in this commonwealth and (i) the base of operations or, if there is no base of operations, the place from which the service is directed or controlled is in this commonwealth, or (ii) the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the employee's residence is in this commonwealth.

* * *

(f)

The sales factor is a fraction, the numerator of which is the total sales of the corporation in this commonwealth during the taxable year, and the denominator of which is the total sales of the corporation everywhere during the taxable year. As used in this subsection, "sales" means all gross receipts of the corporation except interest, dividends, and gross receipts from the maturity, redemption, sale, exchange or other disposition of securities. Sales of tangible

personal property are in this commonwealth if:

1.

the property is delivered or shipped to a purchaser, including the United States government, within this commonwealth regardless of the f. o. b. point or other conditions of the sale; or

2.

the corporation is not taxable in the state of the purchaser and the property was not sold by an agent or agencies chiefly situated at, connected with or sent out from premises for the transaction of business owned or rented by the corporation outside this commonwealth. "Purchaser", as used in clauses 1 and 2 of this paragraph, shall include the United States government.

Sales, other than sales of tangible personal property, are in this commonwealth if:

1.

the income-producing activity is performed in this commonwealth; or

2.

the income-producing activity is performed both in and outside this commonwealth and a greater portion of this income-producing activity is performed in this commonwealth than in any other state, based on costs of performance.

For the purposes of this subsection the corporation will be deemed to be taxable in the state of the purchaser if the tangible personal property is delivered or shipped to a purchaser in a foreign country; sales of tangible personal property to the United States government or any agency or instrumentality thereof for purposes of resale to a foreign government or any agency or instrumentality thereof are not sales made in this commonwealth; and sales by a corporation to its wholly owned DISC shall be treated as though made directly by such corporation to the customer of such DISC.

Notwithstanding the foregoing, mutual fund sales by a mutual fund service corporation as defined in subsection *(m)*, other than the sale of tangible personal property, shall be assigned to this commonwealth to the extent that shareholders of the regulated investment company are domiciled in this commonwealth as follows:

(a)

by multiplying the mutual fund service corporation's total dollar amount of sales of such services on behalf of each regulated investment company by a fraction, the numerator of which shall be the average of the number of shares owned by the regulated investment company's shareholders domiciled in this commonwealth at the beginning of and at the end of the regulated investment company's taxable year that ends

with or within the mutual fund service corporation's taxable year, and the denominator of which shall be the average of the number of shares owned by the regulated investment company shareholders everywhere at the beginning of and at the end of the regulated investment company's taxable year that ends with or within the mutual fund service corporation's taxable year.

(b)

A separate computation shall be made to determine the sale for each regulated investment company, the sum of which shall equal the total sales assigned to the commonwealth.

The commissioner shall promulgate regulations to implement the provisions of this paragraph.

(g)

In a case where only two of the foregoing three factors are applicable, the taxable net income of the corporation shall be apportioned by a fraction, the numerator of which is the remaining two factors with their respective weights and the denominator of which is the number of times that such factors are used in the numerator. If only one of the three factors is applicable, the taxable net income of the corporation shall be apportioned solely by that factor. A factor shall not be deemed to be inapplicable merely because the numerator of the factor is

zero. A factor shall not be applicable if the denominator of the factor is less than ten per cent of one third of the taxable net income or if it is otherwise determined to be insignificant in producing income.

(h)

If a corporation maintains an office, warehouse or other place of business in a state other than this commonwealth for the purpose of reducing its tax under this chapter, the commissioner shall, in determining the amount of taxable net income apportionable to this commonwealth, adjust any factor to properly reflect the amount which the factor ought reasonably to assign to this commonwealth.

(i)

In the case of consolidated returns of net income, the commissioner shall apportion the taxable net income, so far as practicable, in accordance with apportionment rules set forth in this section.

(j)

If the apportionment provisions of this section are not reasonably adapted to approximate the net income derived from business carried on within this commonwealth by any type of industry group, the commissioner may, by regulation, adopt alternative apportionment provisions

to be applied to such an industry group in lieu of the foregoing provisions.

(k) (1)

As used in this section, the following words shall, unless the context otherwise requires, have the following meaning:

"Base period property level", the average value of all the corporation's real and tangible personal property, owned or rented, and used in this commonwealth, as computed under subsection (d), for the corporation's taxable year immediately preceding its first taxable year, on or after January first, nineteen hundred and ninety-six, as adjusted to include only real and tangible personal property actively used by the corporation in the conduct of a trade or business on the first day of the immediately succeeding taxable year.

"Base period payroll level", the total amount paid in this commonwealth for compensation, as computed under subsection (e), excluding amounts paid or attributable to the ten most highly compensated officers, or employees, for the corporation's taxable year immediately preceding its first taxable year beginning on or after January First, nineteen hundred ninety-six, as adjusted to include only compensation paid during such taxable year to individuals who are actively employed by the corporation on the first day of the immediately succeeding taxable year.

"Defense corporation", a domestic or foreign corporation which, during the sixty month period ending on December thirty-first, nineteen hundred and ninety-five, has derived more than fifty percent of its total gross receipts from the manufacture of tangible personal property for sale directly or, in the case of a subcontractor, indirectly, to the Department of Defense or any branch of the Armed Forces of the United States.

"Property level", the average value of all the corporation's real and tangible personal property owned or rented and used in this commonwealth for the corporation's taxable year, as computed under subsection (d).

"Payroll level", the total amount paid in this commonwealth for compensation for the corporation's taxable year, as computed under subsection (e), excluding amounts paid or attributable to the ten most highly compensated officers or employees.

(2)

For any taxable year beginning on or after January first, nineteen hundred and ninety-six but before January first, two thousand, a domestic or foreign defense corporation may, if required to apportion its taxable net income pursuant to subsection (1), elect to have such apportionment determined solely by use of the sales factor. A defense corporation must apportion its income pursuant to said subsection (1) if the denominator of the sales factor is less than

ten percent of the taxable net income or is otherwise determined to be insignificant in producing income. A defense corporation's ability to apportion its taxable net income solely by use of the sales factor shall be reduced to the extent set forth in paragraph (3).

(3)

If for any taxable year beginning on or after January first, nineteen hundred and ninety-six but before January first, two thousand, such corporation's property level is less than ninety percent of the base period property level or its payroll level is less than ninety percent of the base period payroll level, the corporation shall instead be required to apportion its taxable net income for such taxable year to the commonwealth in accordance with subsection (1); provided, however, that any reduction in the property level or payroll level for any taxable year that is demonstrated to be attributable to a net reduction in business in this commonwealth under contracts with any branch of the Armed Forces of the United States or with any military or defense agency of a foreign government not resulting from transfers of contract work to facilities of the corporation in other states shall not be taken into account in determining whether the property or payroll level for such taxable year is less than ninety percent of the comparable base period level.

(4)

The commissioner of revenue shall promulgate rules and regulations implementing the provisions of this subsection.

(5)

For the purposes of determining compliance with the provisions of paragraphs (2), (3) and (4), each defense corporation with more than twenty-five employees, as part of its tax return for each taxable year, shall submit a report, whose form and substance shall be determined by the commissioner of revenue, that describes for each taxable year as of the last day of such taxable year the following:

(i)

the number, nature and wages of jobs added or lost in the commonwealth and worldwide from the previous taxable year;

(ii)

the number of contracts with the Armed Forces of the United States or a foreign government for which a bid was (a) submitted, (b) awarded or (c) lost during the taxable year;

(iii)

the number of contracts with the Armed Forces of the United States or with foreign

governments that were terminated during the taxable year;

(iv)

the nature and amount of any change in the property factor during the taxable year;

(v)

the nature and amount of any change in the payroll factor in the taxable year;

(vi)

the dollar amount of revenue foregone by the adoption and utilization of the single sales actor pursuant to this section as compared to the apportionment method in effect for the first taxable year beginning on or after January first, nineteen hundred and ninety-five;

(vii)

volume of sales in the commonwealth and worldwide;

(viii)

taxable income in the commonwealth and worldwide;

(ix)

book value of plant, land and equipment in the commonwealth and worldwide;

(x)

net capital investment in the commonwealth and worldwide;

(xi)

net assets;

(xii)

capacity utilization; and

(xiii)

debts, itemized by the following categories:

(a)

loans; and

(b)

mortgages.

The commissioner of revenue shall annually prepare a comprehensive report utilizing the information received in this paragraph and other sources describing and evaluating the impact, if any, of the utilization of the single sales factor only upon the defense industry. Said report shall contain only cumulative information for all defense corporations submitting reports. Said report shall set forth for all defense corporations submitting reports the cumulative totals worldwide and, where applicable, in the commonwealth of the items specified in clauses (i) to (xiii) and the changes in such aggregate totals from the previous taxable year. The

commissioner's report shall be filed not later than October first of each year with the clerk of the senate and the clerk of the house of representatives who shall forward the same to their respective committees on ways and means and to the joint committee on taxation. Said report of the commissioner shall be a public record.

(l) (1)

As used in this section, the following words shall, unless the context otherwise requires, have the following meaning:

"Manufacturing corporation", a domestic or foreign corporation that is engaged in manufacturing. In order to be engaged in manufacturing, the corporation must be engaged, in substantial part, in transforming raw or finished physical materials by hand or machinery, and through human skill and knowledge, into a new product possessing a new name, nature and adapted to a new use.

A domestic or foreign manufacturing corporation's activities will be considered to be substantial if any one of the following five tests are met:

1.

twenty-five percent or more of its gross receipts are derived from the sale of manufactured goods that it manufactures;

2.

twenty-five percent or more of its payroll is paid to employees working in its manufacturing operations and fifteen percent or more of its gross receipts are derived from the sale of manufactured goods that it manufactures;

3.

twenty-five percent or more of its tangible property is used in its manufacturing operations and fifteen percent or more of its gross receipts are derived from the sale of manufactured goods that it manufactures;

4.

thirty-five percent or more of its tangible property is used in its manufacturing operations; or

5.

the corporation's manufacturing activities are deemed substantial under relevant regulations promulgated by the commissioner.

In determining whether a process constitutes; manufacturing, the commissioner will examine the facts and circumstances of each case.

For the purposes of this section, a corporation which apportions its income pursuant to subsection (k) is not a manufacturing corporation.

(2)

if a manufacturing corporation, as defined paragraph (1), has income from business activity which is taxable both within and without this commonwealth, its taxable net income, determined under, the provisions of subsection (a), shall not be apportioned pursuant to the percentage that results from the three-factor formula set forth in subsection (c) but, instead, shall be apportioned by multiplying its taxable net income, determined under the provisions of subsection (a), by the resulting percentage as determined in the following formulas:

(i)

For taxable years beginning on or after January first, nineteen hundred and ninety-six but before January first, nineteen hundred and ninety-seven, twenty percent of the property factor plus twenty percent of the payroll factor plus sixty percent of the sales factor.

(ii)

For taxable years beginning on or after January first, nineteen hundred and ninety-seven but before January first, nineteen hundred and ninety-eight, fifteen percent of the property factor plus fifteen percent of the payroll factor plus seventy percent of the sales floor.

(iii)

For taxable years beginning on or after first, nineteen hundred and ninety-eight but before January first, nineteen hundred and ninety-nine, ten percent of the property factor plus ten percent of the payroll factor plus eighty percent of the sales factor.

(iv)

For taxable years beginning on or after January first, nineteen hundred and ninety-nine but before January first, two thousand, five percent of the property factor plus five percent of the payroll factor plus ninety percent of the sales factor.

(v)

For taxable years beginning on or after January first, two thousand, one hundred percent of the sales factor.

(3)

Each manufacturing corporation with more than twenty-five employees, apportioning its income in accordance with the provisions of this subsection, as part of its tax return for each year, shall submit a report, whose form and substance shall be determined by the commissioner of revenue, that describes for each taxable year as of the last day of such taxable year the following:

(i)

the number, nature and wages of jobs added or lost in the commonwealth and worldwide from the previous taxable year;

(ii)

the nature and amount of any change in the property factor during the taxable year;

(iii)

the nature and amount of any change in the payroll factor in the taxable year;

(iv)

the dollar amount of revenue foregone by the increased weighting of the sales factor pursuant to this section as compared to the apportionment method in effect for the first taxable year beginning on or after January first, nineteen hundred and ninety-five;

(v)

volume of sales in the commonwealth and worldwide;

(vi)

taxable income in the commonwealth and worldwide;

(vii)

book value of plant, land and equipment in the commonwealth and worldwide;

(viii)

net capital investments in the commonwealth and worldwide;

(ix)

net assets;

(x)

capacity utilization; and

(xi)

debts, itemized by the following categories:

(a)

loans; and

(b)

mortgages.

The commissioner of revenue shall annually prepare a comprehensive report utilizing the information received in this paragraph and other sources describing and evaluating the impact, if any, of the utilization of the increased weighting of the sales factor upon the manufacturing industry. Said report shall contain only cumulative information for all manufacturing corporations submitting reports. Said report shall set forth for all manufacturing corporations submitting reports the cumulative totals worldwide and, where applicable, in the commonwealth of the items specified in clauses (i) to (xi) and the changes in such aggregate totals

from the previous taxable year. The commissioner's report shall be filed not later than October first of each year with the clerk of the senate and the clerk of the house of representatives who shall forward the same to their respective committees on ways and means and to the joint committee on taxation. Said report of the commissioner shall be a public record subject to the provisions of section ten of chapter sixty-six.

As used in this subsection and in subsections *(c)* and *(f)* the following words shall, unless the context otherwise requires, have the following meaning:

"Administration services", include, but are not limited to, clerical, fund or shareholder accounting, participant record keeping, transfer agency, book-keeping, data processing, custodial, internal auditing, legal and tax services performed for a regulated investment company, but only if the provider of such service or services during the taxable year in which such service or services are provided also provides or is affiliated with a person that provides management or distribution services to any regulated investment company.

"Affiliate", the meaning as set forth in 15 USC section a-2(a)(3)(C), as may be amended from time to time.

"Base period employment level", the number of qualified employees in this commonwealth of a mutual fund service corporation as of

January first, nineteen hundred and ninety-six, or if the mutual fund service corporation is one of the mutual fund service corporations filing a combined return for the tax year ending as of December thirty-first, nineteen hundred and ninety-six, the aggregate number of all qualified employees as of January first, nineteen hundred and ninety-six of all of the mutual fund service corporations participating in such combined return. If a mutual fund service corporation was not engaged in business in the commonwealth on January first, nineteen hundred and ninety-six, the base period employment level shall be the average employment level for the first two taxable years during which it is engaged in business in the commonwealth. In the event of the acquisition of a business or line of business or any other corporate restructuring that increases the number of qualified employees of the mutual fund service corporation, the base period employment level to be applied in the taxable year in which the acquisition or restructuring occurs and in all subsequent taxable years shall be increased to reflect was an increase. In the event of a divestiture of a line of business or other corporate restructuring that decreases the number of qualified employees of the mutual fund service corporation, the base period employment level to be applied in the taxable year in which such divestiture or other corporate restructuring occurs and in all subsequent taxable years shall be

recalculated to reflect such decrease only if the mutual fund service corporation can demonstrate that such divestiture or other corporate restructuring will not result in any reduction in the number of jobs in the commonwealth.

"Distribution services", include, but are not limited to, the services of advertising, servicing, marketing or selling shares of a regulated investment company, but, in the case of advertising, servicing or marketing shares, only where such service is performed by a person who is, or in the case of a close end company, was, either engaged in the services of selling regulated investment company shares or affiliated with a person that is engaged in the service of selling regulated investment company shares. In the case of an open end company, such service of selling shares must be performed pursuant to a contract entered into pursuant to 15 USC section a-15(b), as from time to time amended.

"Domicile", presumptively the shareholder's mailing address on the records of the regulated investment company. If, however, the regulated investment company or the mutual fund service corporation has actual knowledge that the shareholder's primary residence or principal place of business is different than the shareholder's mailing address said presumption shall not control. If the shareholder of record is a company which holds the shares of the regulated

investment company as depositor for the benefit of a separate account, then the shareholder shall be the contract owners or policyholders of the contracts or policies supported by the separate account, and it shall be presumed that the domicile of said shareholder is the contract owner's or policyholders mailing address to the extent that the company maintains such mailing addresses in the regular course of business. If the regulated investment company or the mutual fund service corporation has actual knowledge that the shareholder's principal place of business is different than the shareholder's mailing address said presumption shall not control.

"Employment level", the number of qualified employees of the mutual fund service corporation in the taxable year, or if the mutual fund service corporation is one of the mutual fund service corporations filing a combined return for such taxable year, the sum of the number of qualified employees of all such mutual fund service corporations in this commonwealth for the taxable year.

"Jobs commitment level", except as provided in subparagraph (b) of paragraph (4), for taxable years beginning on or after January first, nineteen hundred and ninety-seven, but before January first, nineteen hundred and ninety-eight, an employment level of one hundred and five percent of the base period employment level; for taxable years beginning on or after January first, nineteen

hundred and ninety-eight, but before January first, nineteen hundred and ninety-nine, an employment level of one hundred and ten percent of the base period employment level; for taxable years beginning on or after January first, nineteen hundred and ninety-nine, but before January first, two thousand, an employment level of one hundred and fifteen percent of the base period employment level; for taxable years beginning on or after January first, two thousand, but before January first, two thousand and one, an employment level of one hundred and twenty percent of the base period employment level; for taxable years beginning on or after January first, two thousand and one, but before January first, two thousand and two, an employment level of one hundred and twenty-five percent of the base period employment level; for taxable years beginning on or after January first, two thousand and two, but before January first, two thousand and three, an employment level of one hundred and twenty-five percent of the base period employment level. If a mutual fund service corporation was not engaged in business in the commonwealth on January first, nineteen hundred and ninety-six, for all taxable years beginning before January first, two thousand and three, the jobs commitment level shall be the base period employment level increased by five percent of the base period employment level for every

year after which the base period employment level is established.

"Management services", include, but are not necessarily limited to, the rendering of investment advice directly or indirectly to a regulated investment company, making determinations as to when sales and purchases of securities are to be made on behalf of the regulated investment company, or the selling or purchasing of securities constituting assets of a regulated investment company, and related activities, but only where such activity or activities are performed: (i) pursuant to a contract with the regulated investment company entered into pursuant to 15 USC section a-15(a), as from time to time amended; (ii) for a person that has entered into such contract with the regulated investment company, or (iii) for a person that is affiliated with a person that has entered into such contract with a regulated investment company.

"Mutual fund sales", taxable net income derived within the taxable year directly or indirectly from the rendering of management, distribution or administration services to a regulated investment company, including net income received directly or indirectly from trustees, sponsors and participants of employee benefit plans which have accounts in a regulated investment company.

"Mutual fund service corporation", any corporation doing business in the commonwealth which derives more than fifty percent of its gross income from the provision directly or indirectly of management, distribution or administration services to or on behalf of a regulated investment company and from trustees, sponsors and participants of employee benefit plans which have accounts in a regulated investment company.

"Number of qualified employees", the number of qualified employees who are employed by a mutual fund service corporation in the commonwealth as of the last day of a given taxable year.

"Number of qualified employees worldwide", the total number of qualified employees worldwide who were employed by the mutual fund service corporation on a specified date.

"Qualified employee in this commonwealth", an individual who: (i) is employed by a mutual fund service corporation; (ii) works on a full-time basis with a normal work week of thirty or more hours; (iii) at the inception of the employment relationship does not have a termination date which is either a date certain or determined with reference to the completion of some specified scope of work, (iv) is eligible to receive employee benefits including, but not limited to, paid holidays, vacation and unemployment benefits; and (v) is subject to Massachusetts income tax withholding. Three or fewer

individuals who collectively fulfill the requirement of clause (ii) and who each meet the requirements of clauses (i), (iii), (iv) and (v) shall be counted as one qualified employee for purposes of this section.

"Qualified employee worldwide", an individual who meets the criteria in subsections (i) to (iv), inclusive, of the definition of "Qualified employee in this commonwealth." Three or fewer individuals who collectively fulfill the requirement of clause (ii) of said definition of "Qualified employee in this commonwealth." and who each meet the requirements of clauses (i), (iii) and (iv) of said definition of "Qualified employee in this commonwealth" shall be counted as one qualified employee for purposes of this section.

"Regulated investment company", the meaning as set forth in section 851 of the Internal Revenue Code as amended and in effect for the taxable year.

(2)

Notwithstanding any other provision of the General Laws, any mutual fund service corporation moving income from mutual fund sales to one or more regulated investment companies with shareholders domiciled within and without this commonwealth shall apportion such income pursuant to the provisions of subsection *(c)*. Furthermore, any such mutual fund service corporation whose employment level in the current

taxable year is equal to or greater than its jobs commitment level for such taxable year and who satisfies the requirements of paragraphs (3) and (4), or any such mutual fund service corporation for which the jobs commitment level requirement no longer applies shall apportion such income by multiplying it by one hundred percent of the sales factor, subject to the provisions of clause (i). The provisions of paragraph (2) of subsection *(m)* shall take effect as of July first, nineteen hundred and ninety-seven. For taxable years beginning on or after January first, nineteen hundred and ninety-seven and including July first, nineteen hundred and ninety-seven, a mutual fund service corporation shall apportion its taxable income to this commonwealth for such taxable year by multiplying taxable net income by the percentage calculated by weighting the apportionment percentage determined under subsection *(c)*, as in effect before July first, nineteen hundred and ninety-seven, by the number of days in such taxable year preceding July first, nineteen hundred and ninety-seven and by weighting the apportionment percentage determined under said paragraph (2) of said subsection *(m)* by the number of days in such taxable year on and after July first, nineteen hundred and ninety-seven.

(3)

Notwithstanding a mutual fund service corporation's failure to achieve its jobs

commitment level in the taxable year, the percentage set forth in the second paragraph of paragraph (2) of subsection *(m)* may be applied, where the failure to achieve the jobs commitment level for any taxable year is demonstrated by the mutual fund service corporation to be a direct result of adverse economic conditions in that taxable year.

(a)

Adverse economic conditions can affect only one taxable year except as set forth in subparagraph (b) and (c). Adverse economic conditions shall exist only where during any twelve month period ending during the taxable year, either: (A) the Standard & Poor's 500 Stock Index decreases ten percent or more compared to its level at the beginning of such twelve month period or (B) the average daily trading volume on the New York Stock Exchange decreases fifteen percent or more compared to the average over the preceding twelve months; or (C) at any time during the taxable year, the total assets under management of the mutual funds served by the mutual fund service corporation decreases twelve and one-half percent or more compared to such total assets under management twelve months earlier.

(b)

If a mutual fund service corporation demonstrates that failure to achieve the jobs commitment level for one taxable year was

the direct result of an adverse economic condition, such corporation may decrease its jobs commitment level by five percent of the base period employment level for all subsequent taxable years prior to the first taxable year beginning on or after January first, two thousand and two.

(c)

If a mutual fund service corporation demonstrates that failure to achieve the jobs commitment level for more than one taxable year was the direct result of an adverse economic condition, such corporation may decrease its jobs commitment level by five percent of the base period employment level for each taxable year in which an adverse economic condition was established for all subsequent taxable years prior to the first taxable year beginning on or after January one, two thousand and two. However, for each taxable year beginning on or after January first, two thousand and two, but prior to the first taxable year beginning on or after January first, two thousand and four, the jobs commitment level shall be an employment level equal to the sum of: (i) the jobs commitment level for the most recent taxable year immediately prior to such year for which an adverse economic condition was not established; and (ii) five percent of the base period employment level.

(4)

For the purposes of determining compliance with the provisions of this subsection, each mutual fund service corporation that seeks to rely on the provisions of this subsection for the taxable year in question shall submit, as part of its tax return, a report, with such supporting documentation as the commissioner may require, containing the following:

(i)

the number, nature, and aggregate wages of the qualified employees in this commonwealth and qualified employees worldwide as of the end of the taxable year and the number of jobs added or lost as compared to the previous taxable year;

(ii)

the number of the qualified employees in this commonwealth as of the last day of the taxable year sorted by place of employment;

(iii)

the base period employment level;

(iv)

the volume of sales attributable to this commonwealth and worldwide;

(v)

the taxable income in this commonwealth;

(vi)

net assets under management in this commonwealth and worldwide; and

(vii)

the median income of all of qualified employees in the commonwealth and of all of its qualified employees worldwide.

The information provided by each individual mutual fund service corporation shall be treated as confidential under the provisions of section twenty-one of chapter sixty-two C. Said information shall be used by the commissioner of revenue to prepare a comprehensive annual report setting forth the changes in the aggregate from the previous taxable year for each of the items listed above. The commissioner's report shall also set forth any recommendations the commissioner may have for any amendments to the provisions of this section, and the reasons for any such recommendations. The commissioner's report shall be filed by October first of each year with the clerk of the senate and the clerk of the house of representatives who shall forward the same to the respective committees on ways and means and the joint committee on taxation.

(5)

The commissioner of revenue shall promulgate regulations implementing the provisions of this subsection.

* * *

GENERAL LAWS OF THE COMMONWEALTH OF MASSACHUSETTS, 1932, CHAPTER 63 TAXATION OF CORPORATIONS, Foreign Corporations.

Sec. 39. Excise on foreign corporations.

Except as otherwise provided herein, every foreign corporation, exercising its charter, or qualified to do business or actually doing business in the commonwealth, or owning or using any part or all of its capital, plant or any other property in the commonwealth, shall pay, on account of each taxable year, the excise provided in subsection *(a)* or *(b)* of this section, whichever is greater, except that a foreign insurance mutual holding company organized pursuant to the laws of the state in which it is established shall pay, on account of each taxable year, only the excise provided by clause (2) of subsection (a) or subsection (b), whichever is greater.

The excise levied herein is due and payable on any one or all of the following alternative incidents:

(1)

> The qualification to carry on or do business in this state or the actual doing of business within the commonwealth in a corporate form. The term "doing business" as used herein shall mean and include each and every act, power, right, privilege, or immunity exercised or enjoyed in the commonwealth, as an incident to or by virtue of the powers and privileges acquired by the

nature of such organizations, as well as, the buying, selling or procuring of services or property.

(2)

The exercising of a corporation's charter or the continuance of its charter within the commonwealth.

(3)

The owning or using any part or all of its capital, plant or other property in the commonwealth in a corporate capacity.

It is the purpose of this section to require the payment of this excise to the commonwealth by foreign corporations for the enjoyment under the protection of the laws of the commonwealth, of the powers, rights, privileges and immunities derived by reason of the corporate form of existence and operation.

In the case of a corporation whose taxable year is a period of less than twelve calendar months, the portion of the amount determined under clause (1) of subsection *(a)* shall be multiplied by a fraction whose numerator is the number of months included in the taxable year and whose denominator is twelve.

* * *

(a)

An amount equal to the sum of: –

(1)

Seven dollars per thousand upon the value of –

(i)

its tangible property as determined to be taxable under paragraph 7 of section thirty if a tangible property corporation, or

(ii)

its net worth as determined to be taxable under paragraph 9 of section thirty if an intangible property corporation; and

(2)

Eight and thirty-three one hundredths per cent of its net income determined to be taxable in accordance with the provisions of this chapter.

* * *

(b)

Four hundred dollars.

A foreign corporation shall not be subject to tax under this chapter if the foreign corporation is engaged in the business of selling tangible personal property and taxation of that foreign corporation under this chapter is precluded by the Constitution or laws of the United States, or would be so

precluded except for the fact that the foreign corporation stored tangible personal property in a licensed public storage warehouse, provided, that no portion of any warehouse which is owned or leased by a consignor or consignee of the tangible personal property shall be deemed a licensed public warehouse.

* * *

APPENDIX E

Reg. 830 CMR 63.38.1. Apportionment of Income.

* * *

(9) *Sales Factor.* The sales factor is a fraction whose numerator is total sales of the taxpayer in Massachusetts during the taxable year and whose denominator is total sales of the taxpayer everywhere during the taxable year. A taxpayer's total sales are its gross receipts, with the exception of the items specifically excluded below.

* * *

(d) *Sales Other Than Sales of Tangible Personal Property in Massachusetts.*

1. *General Rule.* Gross receipts from sales, other than sales of tangible personal property, are attributed to Massachusetts if the income-producing activity that gave rise to the receipts was performed wholly within Massachusetts. If income-producing activity is performed both within and without Massachusetts and if the costs of performing the income-producing activity are greater in Massachusetts than in any other one state, then gross receipts are attributed to Massachusetts.

2. *Income-producing Activity Defined.* For purposes of this subsection, an income-producing activity is a transaction, procedure, or operation directly engaged in by a taxpayer which results in a separately identifiable item of income. In general, any activity whose performance creates an obligation of a

particular customer to pay a specific consideration to the taxpayer is an income-producing activity. However, except insofar as required by 830 CMR 63.38.1(9)(d)3.c., below, (relating to the licensing or sale of intangibles), income-producing activity includes only the activities of the taxpayer whose income is being apportioned. Except as provided in 830 CMR 63.38.1(9)(d)3.c., below, income-producing activity does not include activities performed on behalf of a taxpayer by another person, such as services performed on its behalf by an independent contractor or by any other party whose activities are not attributable to the taxpayer for purposes of determining tax jurisdiction under 830 CMR 63.39.1. For example, in the case of a taxpayer who brokers the sale of services that are performed by third parties, the income-producing activity includes only the brokerage activity and not the ultimate services performed, provided that the performance of the ultimate service by the third party is not considered an activity of the taxpayer under 830 CMR 63.39.1 for purposes of determining whether the taxpayer is taxable in the state where the service is performed.

3. *Specific Income-Producing Activities.*

* * *

c. Income-producing activity includes the licensing of intangible property (other than securities) to another party. Intangible property generally includes copyrights, patents, trademarks, trade names, trade secrets, good will, rights, and similar

intangibles, provided that intangible property licensed in conjunction with the sale of tangible property is treated as the sale of tangible property, and provided that sales of partnership interests are governed by 830 CMR 63.38.1(9)(d)3.d. Where a taxpayer licenses intangible property to another party and receives royalties or similar payments for the use of the intangible property, income-producing activity includes the use of the intangible property by such other party. Each use of the intangible property that results in a separately identifiable item of income for the taxpayer shall be a separate income-producing activity and shall be considered a separate use of the intangible property for purposes of 830 CMR 63.38.1(9)(d). In the case of licenses or similar arrangements compensated by a percentage of the licensee's sales, each sale by the licensee that results in a payment to the licenser whether separate from or combined with other payments is an income producing activity.

Gross receipts from the licensing of intangible property are attributable to Massachusetts if the property is used by the licensee solely in Massachusetts. If the licensee uses the intangible property in more than one state, the gross receipts from the licensing are attributable to Massachusetts if the use of the property by the licensee in Massachusetts exceeds its use of the property in any other one state. A sale that resembles a license, such as a contingent sale (a sale in which the receipts from the sale of the intangible property are contingent

upon the purchaser's use of the property), will be treated as a license under this 830 CMR 63.38.1(9)(d)3.c.

i. For purposes of 830 CMR 63.38.1(9)(d)3.c., the use of intangible property is deemed to occur in the state of commercial domicile of the licensee unless the taxpayer or the Commissioner demonstrates that the property is actually used in or geographically associated with another specific state, and that such actual use or association exceeds the use in or association with the state of commercial domicile.

Examples of actual use include the use of patents or trade secrets in a manufacturing process, or the advertisement or retail display of a trademark or trade name. Actual use shall not include activities of sublicensees, provided that the Commissioner may consider activities of sublicensees in the case of licensing, sublicensing, or other sales agreements among affiliated taxpayers.

Examples of geographic association with a specific state include marketing rights, rights under a covenant not to compete, or broadcast rights, if such rights are restricted to a specific geographic area.

ii. Licensing of canned software, transferred on a tangible medium, for purposes other than commercial reproduction, shall be treated as the sale of tangible personal property, rather than as either the licensing of intellectual property or the performance of a service.

* * *

Reg. 830 CMR 63.39.1. Corporate Nexus.

(1) *General.* (a) 830 CMR 63.39.1 describes the circumstances under which a foreign corporation is subject to the tax jurisdiction of Massachusetts under M.G.L. c. 63, §39.

(b) 830 CMR 63.39.1 is organized as follows:

1. General
2. Definitions
3. General Rule For Evaluating Corporate Tax Jurisdiction
4. Activities Within the Scope of M.G.L. c. 63, §39
5. Exception for Solicitation Activities Protected By P.L. 86-272
6. Other Exceptions
7. Independent Contractors
8. Corporate Partners
9. Nexus Determinations
10. Examples

(2) *Definitions.*

Commissioner, the Commissioner of the Massachusetts Department of Revenue or the Commissioner's duly authorized representative.

Corporate Form, a form of organization recognized in Massachusetts as that of foreign corporation under M.G.L. c. 63, §30(2), whether or not

the entity is described as a corporation by the state under whose laws the entity or organized.

Documentary Evidence, journals, books of account, invoices, expense reports, or other records that are maintained by the taxpayer in the regular course of its business. Generally, an affidavit or other document prepared in anticipation of, or in response to a tax audit, examination, or litigation is not documentary evidence.

Employee, any person who, under the usual common-law rules applicable in determining the employer-employee relationship, has the status of an employee. A person is presumed to be an employee of a foreign corporation, rather than an independent contractor, if the foreign corporation treats that person as an employee for purposes of the payroll taxes imposed by the Federal Insurance Contributions Act.

Foreign Corporation, an entity defined as a foreign corporation under M.G.L. c. 63, §30(2).

Independent Contractor, an independent contractor as defined in 830 CMR 63.39.1(7).

Licensed Public Warehouse, any building or part thereof maintained as a business for the public storage of goods, wares, and merchandise by a warehouseman licensed under the provisions of M.G.L. c. 105, provided however that any portion of a warehouse owned or leased by a consignor or consignee of tangible personal property stored in the

warehouse is not a licensed public warehouse for purposes of M.G.L. c. 63, §39.

Missionary sales activity, generating retail demand for the products of a manufacturer or distributor (and indirectly generating wholesale orders for those products) by promoting the products to retailers who typically order the products from a wholesaler or other middleman.

Office, a permanent or temporary location where a corporation makes sales or holds itself out to the public as conducting business. An in-home office of a corporation's sales representative is generally not an 'office' of the corporation for purposes of 830 CMR 63.39.1, provided that the representative does not publicly hold himself out as doing business on behalf of the corporation at that location, either by publishing the home address as a corporate business address or through other actions.

Partnership, any entity considered to be a partnership under common law rules, under the provisions of the Uniform Partnership Act, or under the provisions of the Uniform Limited Partnership Act. A corporate trust that is subject to the provisions of M.G.L. c. 62 is not considered to be a partnership for purposes of 830 CMR 63.39.1.

Representative, an employee of a corporation, or any person who otherwise acts on behalf of the corporation, provided that an independent contractor as defined in 830 CMR 63.39.1(7) is not a representative.

Sample or display area, a temporary location, such as a hotel room or trade show exhibit, where representatives of a foreign corporation exhibit samples, but do not make sales, approve orders for sales, or conduct any of the activities listed in 830 CMR 63.39.1(4)(d).

Samples, representative samples of the product of a foreign corporation that are used in sales demonstrations or are distributed in limited quantities, without charge, to acquaint existing or prospective customers with the corporation's products. Gemstones or other unique items held for sale by a sales representative are not samples.

(3) *General Rule for Evaluating Corporate Tax Jurisdiction.* M.G.L. c. 63, §39, imposes an excise upon all foreign corporations that enjoy, under the protection of the laws of the Commonwealth, the powers, rights, privileges, and immunities derived from the corporate form of existence and operation. The Commissioner will construe M.G.L. c. 63, §39, as asserting the tax jurisdiction of Massachusetts to the extent permitted by the Constitution and laws of the United States, unless a specific statutory exclusion from taxation exists. In general, a foreign corporation is subject to the tax jurisdiction of Massachusetts under M.G.L. c. 63, §39, if it engages in any of the activities listed in 830 CMR 63.39.1(4), unless those activities fall within the exceptions described in 830 CMR 63.39.1(5) (relating to P.L. 86-272) or 830 CMR 63.39.1(6) (other exceptions).

(4) *Activities Within the Scope of M.G.L. c. 63, §39.* Except as provided in 830 CMR 63.39.1(5)-(6), a foreign corporation must file a return in Massachusetts and pay the associated excise if any one or more of the following apply:

(a) the corporation is qualified to do business in Massachusetts under M.G.L. c. 181, §4;

(b) the corporation actually does business in Massachusetts, whether or not it has qualified to do so. For purposes of M.G.L. c. 63, §39, "doing business" includes:

1. the buying, selling or procuring of services or property;

2. the execution of contracts;

3. the exercise or enforcement of contract rights;

4. the maintenance of a place of business;

5. the employment of labor;

6. each and every other act, power, right, privilege, or immunity exercised or enjoyed in the Commonwealth as an incident to or by virtue of the powers and privileges acquired through corporate form;

(c) the corporation exercises or continues its charter within Massachusetts;

(d) the corporations owns or uses any part of all of its capital, plant, or other property in the Commonwealth in a corporate capacity (as opposed to a strictly fiduciary capacity). Without limitation, a corporation owns or uses property in Massachusetts if:

1. the corporation owns property that is held by another in Massachusetts under a lease, consignment, or other arrangement;

2. the corporation uses property in Massachusetts that it holds under a lease, license, or other arrangement;

3. the corporation maintains a stock of goods in Massachusetts (see, however, 830 CMR 63.39.1(6)(c), regarding property stored in a public warehouse).

(5) *Exception for Solicitation Activities Protected By P.L. 86-272.*

(a) *General; Preemption of State Law.* A foreign corporation whose activities fall within those described in M.G.L. c. 63, §39, and 830 CMR 63.39.1(4) nevertheless is not subject to Massachusetts taxation if Massachusetts is precluded from exercising its jurisdiction by P.L. 86-272 (15 U.S.C. §§381 *et seq.*). P.L. 86-272 currently precludes the imposition of the excise under M.G.L. c. 63, §39, upon a foreign corporation if the sole activity of the corporation in Massachusetts is the solicitation by the corporation's representatives (in the name of the corporation or in the name of a prospective customer)

of orders for the sale of tangible personal property, provided that the orders are sent outside Massachusetts for approval or rejection, and provided that the orders are filled by shipment or delivery by common carrier or contract carrier from a point outside of Massachusetts. Some examples of common solicitation activities are listed in 830 CMR 63.39.1(5)(c).

(b) *Scope of P.L. 86-272.* P.L. 86-272 restricts states' tax jurisdiction with respect to sales to solicitation activities only if the taxpayer's activity is limited to solicitation of orders for the sale of intangible personal property. The protection from state net income taxes provided by P.L. 86-272 does not apply to solicitation activities under the following circumstances:

1. A combination of solicitation activities and other unprotected activities is not protected by P.L. 86-272. If a corporation engages both in protected solicitation activities and in any other activity that is not solicitation of orders for the sale of tangible personal property, it may not claim the immunity provided by P.L. 86-272;

2. Solicitation of orders for the sale or provision of services is not protected by P.L. 86-272. A corporation may not claim the immunity provided by P.L. 86-272 if it sells or provides a mixture of services and tangible personal property to its customers. Typical examples of the sale of a mixture of services and tangible personal property are photographic

development, the fabrication of a customer's materials, the installation of equipment, and the provision of architectural or engineering services;

3. Solicitation of orders for the sale, lease, rental, license, or other disposition of real property or intangibles is not protected by P.L. 86-272.

(c) *Activities Normally Considered to be Solicitation.* The following are examples of activities that ordinarily fall within the scope of "solicitation" under P.L. 86-272.

1. Advertising campaigns incidental to missionary activities;

2. Carrying samples only for display or for distribution without charge or other consideration;

3. Owning or furnishing automobiles to sales representatives, provided that the vehicles are used exclusively for solicitation purposes;

4. Passing inquiries and complaints on to home office;

5. Incidental and minor advertising, i.e., a notice in a newspaper that a sales representative will be in town at a certain time;

6. Missionary sales activities;

7. Checking of customers' inventories (for re-order, but not for other purposes);

8. Maintaining a sample or display area for an aggregate of 14 calendar days or less during the tax year, provided that no sales or other activities inconsistent with solicitation take place;

9. Soliciting of sales by an in-state resident representative of the taxpayer; provided the representative maintains no in-state sales office or place of business;

10. Training sales representatives or holding periodic meetings of sales representatives.

(d) *Activities That Are Not Solicitation.* The following are examples of activities that fall outside of the scope of "solicitation" and are not protected by P.L. 86-272 unless they are *de minimis* within the meaning of *Wisconsin Dept. of Revenue v. William Wrigley, Jr., Co.,* 112 S. Ct. 2447 (1992).

1. Making repairs or providing maintenance;

2. Collecting delinquent accounts;

3. Investigating creditworthiness;

4. Installation or supervision of installation;

5. Conducting training courses, seminars or lectures;

6. Providing engineering functions;

7. Handling customer complaints (other than by referral to home office);

8. Approving or accepting orders;

9. Repossessing property;

10. Securing deposits on sales;

11. Picking up or replacing damages or returned property, including stale or unsalable inventory;

12. Hiring, training, or supervising personnel (other than the training of sales representatives);

13. Providing shipping information and coordinating deliveries;

14. Carrying samples for sale, exchange or distribution in any manner for consideration or other value;

15. Holding meetings of directors, officers, or employees;

16. Supervising the operations of a franchise or similar party;

17. Monitoring, inspecting, or approving a work performed by an independent contractor under a warranty or similar contractual arrangement;

18. Maintaining sample or display area at one location in excess of 14 calendar days during the tax year;

19. Owning, leasing, maintaining or otherwise using any of the following facilities or property in-state:

a. Repair shop;

b. Parts department;

c. Purchasing office;

d. Employment office;

e. Warehouse;

f. Stock of goods (but see 830 CMR 63.39.1(6)(c) regarding property stored in a public warehouse);

g. Mobile stores, i.e., trucks with driver salespersons;

h. Real property or fixtures of any kind;

20. Consigning tangible personal property to any person, including an independent contractor;

21. Maintaining, by either an in-state or an out-of-state resident representative, an office or place of business;

22. Qualifying to do business in Massachusetts;

23. Owning an interest in any partnership, grantor trust, or other pass-through entity whose activities, if conducted directly by a foreign corporation, would give Massachusetts jurisdiction over the foreign corporation under the provisions of 830 CMR 63.39.1(4), unless the activities of the pass-through entity are limited to solicitation protected by P.L. 86-272.

(e) *Rules of Construction.* Where the activities of a foreign corporation fail within the scope of "solicitation" within the meaning of P.L. 86-272 is a factual determination. The examples of activities provided in 830 CMR 63.39.1(5)(c) and (d), respectively, are intended as guidelines. They are not exhaustive and will not precisely describe the activities of many foreign corporations. In applying the guidelines to the particular circumstances and activities of individual foreign corporations, the Commissioner will employ the following rules of construction:

1. The term "solicitation" includes only actual requests for purchases and activities that are entirely ancillary to requests for purchases. An activity is entirely ancillary to the requesting of purchases only if it serves no independent business purpose apart from its connection to the soliciting of orders.

2. Activities conducted by a foreign corporation with respect to a particular order generally do not constitute "solicitation" if they occur after the order has been placed.

3. The effect of the activities listed in 830 CMR 63.39.1(5)(d) is cumulative. When determining whether a taxpayer's activities in excess of solicitation may be *de minimis*, all of these activities must be considered as a whole.

4. If the Commissioner believes that a taxpayer engages in any activity listed in 830 CMR 63.39.1(5)(d), in Massachusetts, the Commissioner will require the

taxpayer to carry the burden of substantiating any claim that its activities were *de minimis*. Documentary evidence will be given substantial weight in establishing the nature and extent of the taxpayer's activities. Affidavits or other evidence not contemporaneous with the events in question will be given little weight.

(As added January 1, 1993.)

(6) *Other Exceptions.*

(a) *General.* A foreign corporation is not subject to the excise under M.G.L. c. 63, §39, if its contacts with Massachusetts are limited exclusively to one or more of the activities listed in 830 CMR 63.39.1.(6)(b)-(e). The activities listed below will not create jurisdiction even if they also fall within the scope of activities that would otherwise create jurisdiction under 830 CMR 63.39.1(4). For purposes of applying this subsection, the qualification to do business in Massachusetts under M.G.L. c. 181 is considered a contact with the Commonwealth that is independent of any other contacts that the foreign corporation may have with Massachusetts or activities that the foreign corporation may conduct in Massachusetts.

(b) *Federal Limitations (Other than P.L. 86-272).* A foreign corporation's activities will not subject it to the jurisdiction of Massachusetts under M.G.L. c. 63, §39, if the Constitution or laws of the United States preclude the exercise of jurisdiction. For discussion of activities currently protected from the exercise of

state tax jurisdiction by P.L. 86-272, see 830 CMR 63.39.1(5).

(c) *Property in Transit or Public Warehouse.* A foreign corporation is not subject to the corporate excise under M.G.L. c. 63, §39, because of its ownership of tangible personal property in actual transit through Massachusetts in the possession and control of a common or contract carrier (provided, however, that this provision shall not preclude the exercise of jurisdiction over foreign carriers whose vehicles enter Massachusetts) or because of its ownership of tangible personal property stored in a licensed public warehouse in Massachusetts. The exemption from taxation provided by M.G.L. c. 63, §39, for the ownership of goods stored in a licensed public warehouse will not be lost because of the shipment of those goods by common or contract carriers from the public warehouse to locations either within or outside of Massachusetts (provided, however, that the exemption does not extend to foreign carriers whose vehicles enter Massachusetts).

(d) *Ownership of Shares.* A foreign corporation is not subject to the corporate excise under M.G.L. c. 63, §39, because of its mere ownership of shares of a corporation that does business in Massachusetts.

(e) *Maintenance of Accounts.* A foreign corporation is not subject to the corporate excise under M.G.L. c. 63, §39, because of its depositing of funds or maintenance of securities brokerage accounts with financial institutions, unrelated to

the foreign corporation, that do business in Massachusetts.

(7) *Independent Contractors.* For the purposes of determining whether a foreign corporation is subject to the excise under M.G.L. c. 63, §39, the activities of employees, agents, or representatives, however designated, of the foreign corporation will be imputed to the corporation. An agent or representative may be an individual, corporation, partnership, or other entity. Activities of an independent contractor will not be imputed to the corporation. For purpose of 830 CMR 63.39.1(7), a person is an independent contractor only if all of the following conditions are met.

(a) The person is not an employee of the foreign corporation.

(b) The person is not subject, in the performance of activities on behalf of the foreign corporation, to the supervision or control (whether or not exercised) of the foreign corporation or any of that corporation's representatives. Whether a purported independent contractor is subject to the supervision or control of a foreign corporation or any of its representatives within the meaning of 830 CMR 63.39.1(7)(b) is a question of fact.

(c) The person holds himself out to the public as an independent contractor in the regular course of its business.

(d) The person must regularly act on behalf of at least one bona fide principal apart from the foreign corporation. Partners, corporate affiliates, or other closely related parties are not separate principals for purposes of 830 CMR 63.39.1(7)(d).

(e) The person may not approve orders on behalf of the foreign corporation or otherwise execute contracts on behalf of the foreign corporation, provided that:

1. to the extent permitted by P.L. 86-272, a person may sell or solicit orders for the sale of tangible personal property on behalf of a foreign corporation without losing the status of an independent contractor, and

2. a financial institution that holds itself out to the public as an investment advisor, providing investment advice and/or management services, including portfolio accounting or bookkeeping services, custodial services, and related financial services to unrelated third parties shall not lose the status of an independent contractor by virtue of any authority that it may have to execute contracts related to the purchase, sale, or management of securities on behalf of those third parties.

(8) *Corporate Partners.*

(a) *General Rule – Partnership Activities Attributed to Partners.* Except as provided by 830 CMR 63.39.1(8)(b)-(d), a foreign corporation uses its capital in Massachusetts, does business in

Massachusetts, and is subject to the excise under M.G.L. c. 63, §39, if the corporation is a general or limited partner in a partnership whose activities, if conducted directly by a foreign corporation, would subject that corporation to the corporate excise under the provisions of M.G.L. c. 63, §39. In the case of a tiered partnership, as defined in 830 CMR 63.39.1(8)(b)3, the activities of the partnership(s) occupying the lower tier(s) of a tiered partnership arrangement are imputed, proportionally, to all partners holding interests in partnership(s) occupying higher tier(s).

(b) *Exception for Certain Partnerships Dealing in Securities.* A foreign corporation is not subject to the excise under M.G.L. c. 63, §39, by reason of its status as a limited partner in a partnership that is engaged exclusively in buying, selling, dealing in, or holding securities on its own behalf, and not as a broker, provided that the foreign corporation is not otherwise subject to the excise under M.G.L. c. 63, §39. See generally M.G.L. c. 62, §17.

1. In general, the exception in 830 CMR 63.39.1(8)(b) does not extend to an upper tier partnership in a tiered partnership arrangement, merely by virtue of the tiered structure. However, an upper tier partnership that is engaged exclusively in buying, selling, dealing in, or holding securities (apart from any limited partnership interests) in its own behalf, and not as a broker, may include among the securities in its portfolio, limited partnership interests in unrelated partnerships that conduct

business activity in Massachusetts, without subjecting its corporate limited partners to the excise under M.G.L. c. 63, §39.

2. If an upper tier partnership in a tiered partnership arrangement is a limited partner of a lower tier partnership that is engaged exclusively in buying selling dealing in, or holding securities on its own behalf, and not as a broker, the activities of the lower tier partnership will not, in themselves, subject corporate partners of the upper tier partnership to the excise under M.G.L. c. 63, §39.

3. A tiered partnership arrangement is one in which some or all of the interests in one partnership (lower tier partnership) are held by a second partnership (upper tier partnership). A tiered partnership arrangement may have two or more tiers.

(c) *Exception for Publicly Traded Partnerships.* A foreign corporation that holds a limited partnership interest in a publicly traded partnership, as defined in Code §7704, that conducts business activity in Massachusetts, is not subject to the excise under M.G.L. c. 63, §39, unless the activities of that foreign corporation otherwise establish nexus with Massachusetts.

(d) *De Minimis Exception.* Under circumstances specified in 830 CMR 63.39.1(8)(d)1.-2., the Commissioner ordinarily will treat the holding of a limited partnership interest by a foreign corporation as a *de minimis* connection with Massachusetts and will not seek to impose the excise under M.G.L. c. 63,

§39, on that corporate limited partner, despite the conduct of business activities by the partnership in Massachusetts. This *de minimis* rule applies only to foreign corporations that, apart from their limited partnership holdings, are not subject to the excise under M.G.L. c. 63, §39. The *de minimis* rule does not apply to apply to any limited partner that is subject to tax under M.G.L. c. 62 or to any general partner. The application of the *de minimis* rule is subject to the ownership attribution principles and other conditions stated in 830 CMR 63.39.1(8)(d)3.-4.

1. The Commissioner ordinarily will treat a limited partnership interest of a foreign corporation as a *de minimis* connection with Massachusetts if the foreign corporation owns less than a five percent interest in the partnership and if neither the Massachusetts property of the partnership, nor its Massachusetts payroll, nor its Massachusetts sales, when multiplied by the foreign corporation's interest in the partnership, exceeds $10,000. The Massachusetts property, payroll, and sales of the partnership shall be calculated under the rules provided in M.G.L. c. 63, §38. The interest of a limited partner in a partnership shall be its distributive share of the partnership's income, gain, loss, or credit, (whichever may be greatest) determined pursuant to Code §704.

2. Under extraordinary circumstances, the Commissioner may agree that a limited partnership holding of a foreign corporation is a *de minimis* connection with Massachusetts, even if the test

stated in 830 CMR 63.39.1(8)(d)1. is not satisfied. In order to obtain the Commissioners agreement to *de minimis* treatment under 830 CMR 63.39.1(8)(d)2., a foreign corporation must establish to the Commissioner's satisfaction, during the course of an audit, by application for abatement, or by a determination under 830 CMR 63.39.1(9), that under the particular facts and circumstances applicable to the foreign corporation and the limited partnership, the connection between the foreign corporation and the Commonwealth is so inconsequential that the imposition of the corporate excise on the foreign corporation would constitute an unconstitutional extension of the tax jurisdiction of Massachusetts.

3. For purposes of applying the *de minimis* rule under 830 CMR 63.39.1(8)(d), a corporate limited partner is treated as owning all interests in a partnership that it owns either directly or indirectly, including all interests of any party whose direct or indirect stock ownership would be attributed to the corporate limited partner under the provisions of section 318 of the Internal Revenue Code. Furthermore, if a corporation owns (or is treated as owning) limited partnership interests in two or more partnerships that conduct business activity in Massachusetts, other than publicly traded partnerships as defined by Code §7704, the Massachusetts property, payroll, and sales represented by those interests, as calculated above, must be aggregated when applying the *de minimis* rule.

4. Any corporate limited partner that claims not to be subject to the excise under M.G.L. c. 63, §39, because of the *de minimis* rule stated in 830 CMR 63.39.1(8)(d) bears the burden of establishing its claim to the Commissioner's satisfaction. In order to provide its corporate limited partners with the information necessary to make a *de minimis* calculation, any partnership that is required to file Massachusetts Form 3 and that has limited interest held by foreign corporations shall complete Part III of that Form (Income Apportionment) and shall provide a copy of the completed form to any partner that requests one.

Example. The following example illustrates the provisions of 830 CMR 63.39.1(8)(d):

Some Place Partners, L.P., (Partnership) is a limited partnership that owns an office building at One Some Place in Boston. The Partnership purchased the property for $5 million and receives $500,000 gross annual rent. The partnership has no payroll and no other property or sales in Massachusetts. Corporation X, a foreign corporation, is a limited partner with a one percent capital and income interest in the Partnership. Corporation X has no other contacts with Massachusetts. Corporation X is subject to excise under M.G.L. c. 63, §39, and does not qualify for the *de minimis* exception of 830 CMR 63.39.1(8)(d) because the Massachusetts property attributable to Corporation X exceeds $10,000. Specifically: 0.01 x $5,000,000 = $50,000.

(e) *Effective Date.* The provisions of 830 CMR 63.39.1(8), shall apply to taxable years commencing on or after the effective date of this regulation, 830 CMR 63.39.1.

(f) *Presumption of Separate Accounting.* If a foreign corporation is subject to the tax jurisdiction Massachusetts under M.G.L. c.63, §39, only by virtue of its status as a limited partner of a partnership that conducts business in Massachusetts, and if the foreign corporation owns no more than 50% of the interests in the partnership, the Commissioner will presume that income received by the corporation from sources other than either the partnership or the disposition of its limited partnership interest is not derived from business activity carried on within the Commonwealth within the meaning of M.G.L. c.63, §38. Unless this presumption is rebutted either by the Commissioner or by the taxpayer, the Commissioner will require the foreign corporation to account separately for its partnership income and to apportion this separate income to Massachusetts in accordance with the rules of M.G.L. c. 63, §38 or 42, using only the partnership's property, payroll, and sales to determine an apportionment percentage. The separate accounting shall apply both to the determination of income subject to apportionment under M.G.L. c.63, §38 or 42, and to the determination of the property measure of excise under M.G.L. c.63, §39(a)(1).

Either the Commissioner or a taxpayer may rebut the presumption of separate accounting by

demonstrating that the corporate limited partner and the partnership are engaged in a unitary business. If a corporate limited partner has engaged in a unitary business with the partnership in one or more taxable years, the corporation may not separately account in any taxable year for the income it derives from the partnership. Instead, the foreign corporation shall apportion to Massachusetts all income derived from business activity carried on within the Commonwealth, including income derived from its partnership interest, in accordance with the rules of M.G.L. c.63, §38 or 42 using the corporation's own property, payroll, and sales plus its *pro rata* portion of the partnership's property, payroll, and sales to determine an apportionment percentage.

If a foreign corporate limited partner engages in a unitary business with its partnership, the activities of the partnership shall be deemed to be activities of the limited partner for purposes of determining whether the taxation of the limited partner is precluded by P.L. 86-272.

(9) *Nexus Determinations.*

(a) *Applications.* A foreign corporation may apply to the Commissioner for a determination of whether the corporation is subject to tax under M.G.L. c.63, §39, in a particular taxable year. A request for a nexus determination for a taxable year must be mailed to the Commissioner, at the address stated below, on or before the last day of the first quarter of the taxpayer's taxable year. The request

should generally conform to the requirements of a request for a letter ruling under 830 CMR 62C.3.2, and, in addition, the corporation must complete a nexus questionnaire provided by the Commissioner. The Commissioner may choose to treat any request for a nexus determination as a letter ruling application and may issue and publish such a ruling as provided by 830 CMR 62C.3.2, but nexus determinations generally will not be published.

Foreign corporations that wish to request a nexus determination should write to:

Massachusetts Department of Revenue

Rulings and Regulations Bureau, Room 703

100 Cambridge Street

Boston, MA 02204

(b) *When Nexus Determinations Will Be Issued.* The Commissioner ordinarily will make a nexus determination prospectively, regarding business activity that a taxpayer has not yet undertaken in Massachusetts, after receiving a proper request, but the Commissioner may decline to make a determination in any case, for any reason. The Commissioner ordinarily will not issue a determination to any taxpayer in either of the following circumstances.

1. The Commissioner ordinarily will not issue a determination if, at the time the application is made, the Department is investigating the taxpayer's nexus

with Massachusetts in connection with an audit or other examination.

2. The Commissioner ordinarily will not issue a determination if the taxpayer is currently filing corporate excise returns in Massachusetts.

(c) *Effect of Determination.* A nexus determination extends only to the facts stated in the corporation's request. The nexus determination is not an acknowledgment of the accuracy or completeness of this factual statement. The Commissioner reserves the right to investigate the accuracy and completeness of the corporation's factual statement, either before or after a determination is made. If, after a nexus determination is made, the Commissioner determines that a foreign corporation has engaged in any activities not fully disclosed in its request for a determination that constitute doing business in Massachusetts, the Commissioner may assess excise, including interest and penalties, for any taxable year, including the year for which the determination is issued, within the applicable statute of limitations. (Generally, no statute of limitations applies to periods for which a taxpayer has failed to file a return.)

A valid nexus determination will be binding on the Commissioner with respect to the taxable year for which it is made. A determination that a foreign corporation does not have nexus with Massachusetts will be binding with respect to subsequent taxable years only if there is no change in the controlling law

and only if the taxpayer files an affidavit, signed by an officer authorized to sign tax returns, stating that the taxpayer's Massachusetts activities have not changed from those described in its request for a determination. The affidavit must be filed annually by mailing on or before the last day of the first quarter of the taxpayer's taxable year to the address stated in 830 CMR 63.39.1(9)(a). A determination is automatically revoked if the affidavit is not timely filed. Notwithstanding any affidavit, however, the Commissioner may revoke or reverse a nexus determination prospectively at any time by giving written notice to the taxpayer.

(10) *Examples.* The following examples illustrate the provisions of 830 CMR 63.39.1. Except as stated in Example 7, below, the examples assume that the foreign corporations involved have not qualified to do business in Massachusetts.

Example 1(a). Abundant Acres, Inc., is a foreign corporation that operates as a real estate broker. Abundant Acres has no office or employees in Massachusetts, but it has registered with the Massachusetts Board of Registry for Real Estate Brokers and Salesmen, and it brokers the sale of Massachusetts real estate. Abundant Acres is subject to the excise under M.G.L. c.63, §39, because it is doing business in Massachusetts within the meaning of 830 CMR 63.39.1(4) and because its activities do not constitute solicitation of orders for the sale of tangible personal property. See 830 CMR 63.39.1(5).

Example 1(b). Alluvial Acres, Inc. (Alluvial) is a foreign corporation that is a registered Realtor/ Broker in another state. It is not registered as a real estate broker in Massachusetts, it maintains no offices or agents in Massachusetts, and it owns or leases no real property in Massachusetts.

For a fee, Alluvial will provide space in its computer database to real estate sellers to list their properties. Each property is included in listings compiled for distribution to potential buyers interested in property in the seller's area. Alluvial conducts business by mail or telephone. It solicits property listings through advertisements in national and regional publications. Alluvial does not act as a broker with respect to the sale of Massachusetts real estate. It plays no part in negotiations or settlements, receives no commissions, and has no contact with buyers and sellers other than collecting and distributing information.

Alluvial is not doing business or exercising its charter in Massachusetts. It does not own or use any property in the Commonwealth. It is not subject to the excise under M.G.L.c. 63, §39.

Example 2. Barefoot Builders, Inc. (Barefoot) is a foreign corporation engaged in the leasing of construction vehicles. Barefoot leases vehicles to individuals and businesses in Massachusetts. It has no offices or employees in Massachusetts. Nevertheless, Barefoot is subject to the corporate excise under M.G.L.c. 63, §39, because it owns

property located in Massachusetts and it does not use that property for "solicitation" within the meaning of 830 CMR 63.39.1(5).

Example 3. Convoluted Computers, Inc. (Convoluted) is a foreign corporation that manufactures mainframe computers and peripherals. Convoluted has no offices in Massachusetts. It employs sales representatives who visit Massachusetts periodically to solicit orders. These representatives give presentations explaining the capacities and advantages of Convoluted's computers. The representatives also provide general price information to prospective customers, but they have no authority to accept orders. Final contract negotiations and execution of contracts occur at Convoluted's home office outside of the Commonwealth. Convoluted ships its products to Massachusetts by common carrier.

In addition to its sales representatives, Convoluted also employs technicians who install and service the machines purchased by Massachusetts customers. The technicians are based at Convoluted's home office and travel to the customers facilities only for as long as the installation requires.

Because Convoluted employs workers in the Commonwealth, its activities fall within the scope of M.G.L. c. 63, §39, unless they are protected by P.L. 86-272. Convoluted's sales representatives engage in protected solicitation activities. However, Convoluted's technicians are providing services, not

soliciting sales of tangible property, so their activities are not protected. See 830 CMR 63.39.1(5)(b) and (5)(e). Since foreign corporations that engage in both protected and unprotected activities are subject to the Massachusetts corporate excise, Convoluted must file a return and pay the associated excise.

Example 4. Diffuse Deliveries, Inc. (Diffuse) is a foreign corporation engaged in interstate trucking. Diffuse's trucks frequently transport goods over the roads of Massachusetts, and may or may not pick up or deliver goods in the Commonwealth. Diffuse is subject to the Massachusetts corporate excise because it uses corporate property (trucks) and provides a service (transportation) in Massachusetts and because its activities are not solicitation of orders for the sale of tangible personal property.

Example 5. Eager Educators, Inc. (Eager) is a foreign corporation engaged in the business of conducting and marketing personal development training seminars. Eager either conducts seminars itself, using its own employees, or trains employees of client corporations to run seminars for those corporations. In either circumstance, Eager provides written course materials for each seminar participant. Eager has no offices in Massachusetts.

Eager provides its customers with a combination of services (training or instruction) and tangible property (course materials). Eager will therefore be subject to the Massachusetts corporate excise if it:

(a) conducts seminars in Massachusetts, using its own employees;

(b) contracts to allow one or more clients to conduct seminars in Massachusetts, and

1. the contract is executed in Massachusetts; or

2. Eager's employees come to Massachusetts to train, supervise, or advise client instructors, or to deliver course materials; or

(c) sends employees to trade shows or conventions in the Commonwealth or otherwise solicits sales of services in Massachusetts through sales personnel located in the Commonwealth.

Eager will not be doing business in Massachusetts and will not be subject to excise under M.G.L.c. 63, §39, if its activities in Massachusetts are limited to one or both of the following:

1. solicitation of business by telephone from outside of the Commonwealth; or

2. advertising in trade journals distributed in Massachusetts.

Example 6. Flirtatious Flavors, Inc. (Flirtatious) is a foreign corporation engaged in the manufacture and sale of candies. Flirtatious has no office or retail outlets in Massachusetts. However, it employs three full-time sales representatives who live in Massachusetts and who solicit sales in Massachusetts and other New England states. The sales representatives work out of their homes but do not

store inventory there, and do not publicize their home addresses as business addresses of Flirtatious.

Flirtatious provides each of its sales representatives with a company-owned car. The cars are registered and principally used in Massachusetts. They are garaged at the sales representatives' homes, and are used by the representatives to visit customers.

Flirtatious employs workers and maintains a limited quantity of corporate property (company cars) in Massachusetts. However, its activities, including the activities in which its property is used, are limited to the solicitation of orders for the sale of tangible personal property. See 830 CMR 63.39.1(5). Therefore, it is not subject to the Massachusetts corporate excise.

Example 7. Geronimo Gents, Inc. (Geronimo) is a foreign corporation engaged in the retail sale of designer parachutes and fashionable gentlemen's parachuting attire. In 1988, Geronimo qualified to do business in Massachusetts and opened stores in Fall River and Newton Upper Falls. After high initial sales, Geronimo's profits plunged, and Geronimo abandoned its local operations in 1989. However, despite ceasing Massachusetts business activities, Geronimo remained qualified to do business in the Commonwealth until 1991.

The corporate excise under M.G.L. c. 63, §39, is imposed not only when a corporation does business in Massachusetts, but also when it is qualified to do

business in the Commonwealth. See 830 CMR 63.39.1(4)(a). The qualification to do business is not "solicitation." See 830 CMR 63.39.1(5)(d)22. Geronimo is subject to the corporate excise through its 1991 taxable year.

Example 8. Humble Homes is a foreign corporation that sells furniture. The company regularly delivers furniture that it has sold to locations in Massachusetts using its own delivery trucks. The delivery trucks are corporate property that the company owns or uses in Massachusetts in a corporate capacity within the meaning of 830 CMR 63.39.1(4)(d). The delivery of goods does not constitute "solicitation" of orders. Humble Homes is therefore subject to the excise under M.G.L.c. 63, §39.

Example 9. Invisible Inc. is a foreign corporation that holds intangible assets. Invisible has no employees, tangible property, or sales. However, the majority of its corporate functions are performed in Massachusetts. These corporate functions include maintaining books and records, holding directors' meeting, and making day-to-day business decisions. The corporate functions are performed in Massachusetts by Invisible's directors or by employees of an affiliate. Invisible is subject to the excise under M.G.L. c. 63, §39.

Example 10. Just Javelins, Inc. (Javelins) is a foreign corporation that manufacturers sports equipment outside of Massachusetts. Javelins opens a securities account with a Massachusetts financial

institution. Kindred, Inc., and retains Kindred as a financial advisor. Under an agreement signed by the two companies, Kindred has the authority to invest Javelins' assets in various securities. Officers of Javelins visit Kindred's office in Massachusetts two or three times per year, for one or two days per visit, to review the performance of Javelins' securities portfolio and to discuss future investment plans. Javelins has no other contracts with Massachusetts. Javelins is not doing business in Massachusetts and is not subject to tax under M.G.L.c. 63, §39.

APPENDIX F

Mass.Gov

Department of Revenue

Directive 96-2: Creation of Nexus Through the In-State Ownership and Use of Intangible Property

Issue

Under what circumstances will the in-state ownership and use of intangible property subject a foreign corporation to the corporate excise?

Directive

A foreign corporation's intangible property used within Massachusetts will subject that corporation to the corporate excise when:

1. The intangible property generates, or is otherwise a source of, gross receipts within the state for the corporation, including through a license or franchise; and

2. The activity through which the corporation obtains such gross receipts from its intangible property is purposeful (e.g., a contract with an in-state company); and

3. The corporation's presence within the state, as indicated by its intangible property and its activities with respect to that property, is more than de minimis.

Explanation

Under G.L. c. 63, § 39, a foreign corporation is subject to the corporate excise when, *inter alia*, it does business in Massachusetts, or owns or uses any part or all of its capital, plant, or any other property in the state. The Commissioner construes this provision to the full extent permitted by the Constitution and laws of the United States.

The definition of intangible property generally includes, but is not limited to, copyrights, patents, trademarks, trade names, trade secrets, service marks, and know-how. However, for purposes of this directive, the Commissioner will treat a license of canned software, transferred on a tangible medium to be used for any purpose other than commercial reproduction, as the sale of tangible personal property, not the license of intangible property.

A foreign corporation whose in-state activity is described in G.L. c. 63, § 39 is not subject to the Massachusetts corporate excise if such in-state activity is within the confines of Public Law 86-272 (15 U.S.C. § 381 et seq.). Public Law 86-272 precludes the imposition of a corporate tax measured by net income when a foreign corporation's sole activity in Massachusetts is solicitation of sales of tangible personal property, provided certain conditions are met. For example, Public Law 86-272 could potentially apply to a foreign corporation's solicitation of sales in Massachusetts of tangible personal property which contains intangible property (such as

books, recordings, or canned software). In contrast, the focus of this directive is transactions in which a foreign corporation derives gross receipts from intangible property that is licensed or otherwise transferred for continuing commercial exploitation in the state. These latter transactions are not protected by Public Law 86-272.

Examples

The following examples illustrate the application of this directive. In Examples 1-3, it is presumed that the foreign corporation's presence in Massachusetts, as indicated by its intangible property and its activities with respect to that property, is more than de minimis. Moreover, in Examples 1-3 it is presumed that the foreign corporation does not otherwise transact business or own property in the state.

Example 1

Dress Shop, a Delaware corporation located in Wisconsin, manufactures and sells girls' clothing under the name Tinker Bell. In Year 1, Dress Shop licenses the name Tinker Bell to Girl Towne, a Massachusetts company, for use in connection with the sale of clothing produced by Girl Towne in Massachusetts. Pursuant to the contract entered into between Dress Shop and Girl Towne, Girl Towne is to pay Dress Shop a royalty of 2% on the sale of every item of clothing sold under the Tinker Bell name. Girl Towne makes sales under the Tinker Bell

name in Massachusetts during Year 1 and makes the corresponding royalty payments to Dress Shop, as required. Dress Shop has nexus with Massachusetts in Year 1.

Example 2

Motor Way, a Delaware corporation located in Alabama, develops the technology for a new low-weight motor scooter and patents this technology. In Year 2, Motor Way licenses its patented technology to Speed Rider, a Massachusetts company, for use in connection with the manufacture and sale of scooters in Massachusetts. Pursuant to the contract entered into between Motor Way and Speed Rider, Speed Rider is to pay Motor Way an upfront fee for the right to make use of Motor Way's patented technology, and a royalty of 4% on the sale of every scooter that Speed Rider manufactures and sells using this technology. Speed Rider manufactures scooters using the Motor Way technology in Year 2, and sells these scooters in Massachusetts during that same year. In addition, Speed Rider makes the corresponding royalty payments to Motor Way for Year 2, as required. Motor Way has nexus with Massachusetts in Year 2.

Example 3

Ginzu Ltd. is a fast-food franchiser, incorporated in Delaware and located in New Jersey. In Year 3, Ginzu Ltd. franchises the rights to one of its "Ginzu Gardens" fast-food restaurants to a franchisee, John

Cook, a New Hampshire resident, for a location in Massachusetts. The terms of the franchise agreement both permit and require Mr. Cook to use the various items of intangible property owned by Ginzu Ltd. (e.g., the name "Ginzu Gardens," certain service marks, a patented food process, trade secrets, and know-how). In addition, the terms of the franchise agreement require Mr. Cook to pay Ginzu Ltd. a monthly franchise fee, as well as a royalty charge of 6% of the sales proceeds received by the Massachusetts' restaurant, Ginzu Gardens. Mr. Cook makes such payments to Ginzu Ltd. during Year 3, as required. Ginzu Ltd. has nexus with Massachusetts in Year 3.

Example 4

Golf Time is a corporation, incorporated in South Carolina and located there. Golf Time is the creator of "cold day" golf clubs. "Cold day" golf clubs have grips that emit warmth when squeezed, since they are specially treated with Golf Time's "heat-grip" technology. Golf Time has patented its "heat grip" technology, and obtained registered trademarks for each of the terms "cold day" and "heat-grip." Golf Time solicits sales of its "cold day" golf clubs in Massachusetts, touting the merits of its "heat grip" technology. Golf Time's activities result in significant sales of "cold day" golf clubs in Massachusetts. Golf Time engages in no other business activity with respect to Massachusetts. Assuming Golf Time's Massachusetts activities are protected by Public Law

86-272, Golf Time will not be subject to the corporate excise for the years in question.

Effective Date

The principles set forth in this directive will apply to taxable years beginning on or after January 1, 1996.

Frederick A. Laskey
Senior Deputy Commissioner

July 3, 1996

APPENDIX G

GEOFFREY, INC. V. MASSACHUSETTS COMMISSIONER OF REVENUE OPINION OF PROFESSOR RICHARD D. POMP[1]

(Entered Into Evidence Sept. 27, 2005, Before The Mass. App. Tax Board, *see* Record 714-720, 811)

I. INTRODUCTION

You have contacted me as the former Director of the New York Tax Study Commission and as someone who, for 30 years, has studied, lectured, taught, published, and consulted with, and testified on behalf of, state and local governments regarding issues of state taxation. I have served as a consultant to Alaska, California, Connecticut, Delaware, Hartford, Illinois, Louisiana, Montana, New Jersey, New Mexico, New York, North Dakota, San Francisco, South Carolina, Tennessee, Texas, Utah, West Virginia, and the Multistate Tax Commission. I have also served as a consultant to the Internal Revenue Service, the Department of Justice, the U.S. Congress, the International Monetary Fund, the World Bank, the United Nations, and numerous foreign countries.

I have been qualified as an expert witness in California, Colorado, Connecticut, Delaware, Illinois, Kansas, Louisiana, Massachusetts, Michigan,

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[1] Alva P. Loiselle Professor of Law, Connecticut Law School; Adjunct Professor of Law, NYU Law School (LL.M. Program in Taxation); Adjunct Professor of Law, Columbia Law School.

Montana, New Jersey, New York, New York City, North Carolina, North Dakota, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, Tennessee, Texas, Utah, and West Virginia. About half of these appearances have been on behalf of the states.

Further details are contained in the attached curriculum vitae.

II. OVERVIEW

Geoffrey, Inc. (Appellant) is a Delaware corporation. During the audit years at issue (taxable years ending January 31, 1997 through January 31, 2001), Appellant had its principal place of business first in Delaware and then in New Jersey.

Appellant was incorporated in 1984. In that year, Toys R Us, Inc. transferred trademarks, trade names, and service marks ("Trademarks") to Appellant, including the Toys R Us and Kids R Us trademarks in exchange for stock. Subsequently, Appellant licensed Toys R Us, Inc. to use the Trademarks in all states except New York, Texas, Pennsylvania, Massachusetts, and New Jersey. Appellant entered into a separate license agreement with Toys R Us-Mass., Inc. (TRUMI), under which TRUMI was allowed to use the Trademarks solely in Massachusetts. Appellant received a 2% royalty of TRUMI's net sales at Kids R Us stores in Massachusetts for the use of the Kids R Us trademarks and a royalty of 3% of TRUMI's net sales at Toys R Us in Massachusetts for the use of the Toys R Us trademarks. The royalties were set

pursuant to a third-party transfer pricing study. Appellant also entered into license agreements with other Toys R Us, Inc. affiliates and unrelated entities.

Appellant had no office, tangible personal property, employees, or agents in Massachusetts.

Massachusetts General Law Ch. 63, Sec. 19 provides in relevant part that:

"[E]very foreign corporation . . . actually doing business in the commonwealth, or owning or using any part or all of its . . . property in the commonwealth, shall pay [the corporation excise tax].

Department of Revenue Directive 96-2 (July 3, 1996) provides that:

"A foreign corporation's intangible property used within Massachusetts will subject that corporation to the corporate excise when:

1. The intangible property generates, or is otherwise a source of, gross receipts within the state for the corporation, including through a license or franchise; and

2. The activity through which the corporation obtains such gross receipts from its intangible property is purposeful (e.g., a contract with an in-state company); and

3. The corporation's presence within the state, as indicated by its intangible property and its activities with respect to that property, is more than de minimis."

The Commissioner views the Appellant has having had nexus with Massachusetts because of its license agreement with TRUMI. The Commissioner is asserting a concept of nexus known as economic presence. In contrast, Appellant asserts that because it has no physical presence in Massachusetts it has no nexus. In other words, this case presents a clash between two competing theories of nexus.

You have asked me to discuss from a policy perspective these opposite theories and evaluate them in terms of normative principles. You have asked me not to discuss Massachusetts law or constitutional law.

III. ANALYSIS

Policy Evaluation of Physical and Economic Presence

I evaluate these competing theories, of nexus by asking which is: (1) more consistent with a bright line test; (2) more consistent with settled expectations; (3) more likely to reduce litigation and foster interstate investment; (4) less likely to discriminate against the financial sector; (5) less likely to lead to multiple taxation of national issuers of credit cards; and (6) more likely to be fairly or easily administered.

For the reasons explained below, I conclude that physical presence is clearly superior to economic presence as a nexus standard when measured against any of these criteria.

1. Physical presence is more consistent with a bright line test

A bright line test is especially needed when the issue is nexus. A nexus standard operates in a stark, all or nothing fashion: a company will either be subject to an income-based tax or it will not. The need for a bright line test is especially acute where millions of dollars of income-based taxes can turn on whether nexus exists.

From this policy perspective, an overwhelming virtue of the physical presence standard is that it provides a bright line test. People or tangible property are visible and can be identified through physical observation. Their existence and presence is unambiguous; people or property are either in a state or they or not.

In sharp contrast, economic presence is an amorphous concept, having no crisp edges. Economic presence can be defined in various ways, using various indicia of "presence." One measure of economic presence is intangible property, such as the license and use of trademarks. The essence of intangible property, however, is that it lacks any inherent utilitarian value but merely represents a set of legal rights and obligations. As the dictionary recognizes, intangible

property "cannot be easily defined, formulated, or grasped."[2]

Unlike persons or tangible property that can be identified geographically, intangible property cannot be located in any particular state except through legal fictions or doctrines. One legal fiction includes the doctrine of mobilia sequuntur personam, which would treat a licensing agreement as being attached to the person that owns it. Another approach creates the fiction that an intangible has a business situs but there are different rules to identify that situs.

The problem that arises with all of these legal fictions is that they do not produce a unique solution to where an intangible is located. For example, under the doctrine of mobilia sequuntur personam, the state of legal domicile could take the position that the license agreement was located there. The state of commercial domicile could take the position that it was the location of the agreement. The state where the royalties were generated could take the view that the license agreement was located there.

Compared with a physical presence standard, economic presence not only provides no bright line rule, but also provides no determinate or unique answer to the nexus question. A rule that can locate an intangible simultaneously in more than one state

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[2] Webster's New Universal Unabridged Dictionary (Deluxe 2nd ed.).

is not a principle of nexus but rather an invitation to chaos.

2. Physical presence is more consistent with settled expectations

There is no U.S. Supreme Court case holding that economic presence satisfies commerce clause nexus. All of the U.S. Supreme Court cases dealing with commerce clause nexus for corporate income tax purposes involved corporations that had a physical presence. Indeed, taxpayers have been very careful in structuring their activities to avoid having a physical presence in those states in which they did not wish to have nexus. In my opinion, the expectation of corporate taxpayers is that no nexus exists under the commerce clause without physical presence.

The economic presence rule is obviously inconsistent with this expectation. If this expectation is to be frustrated by the imposition of a new, economic presence rule, Congress is the only appropriate body to do so. Corporations relying on the physical presence standard, such as the issuers of credit cards, have not filed income tax returns on the justifiable assumption that nexus did not exist. Without the filing of a return, the statute of limitations does not run in most states and localities. Consequently, enormous retroactive exposure exists if a new nexus standard is adopted by a jurisdiction. Congress is the ideal body to balance the interests of the various

parties should it decide that the nexus standard should be changed.

3. Physical presence is more likely to reduce litigation and foster interstate investment

The physical presence nexus standard has the weight of history and tradition behind it. It has been litigated over the years and its boundaries are well known and accepted. It provides a knowable and determinable standard. Rules have grown up around this standard that minimize multiple taxation and reduce the likelihood that interstate commerce will be unduly burdened. Long-standing precedent supports the standard, which furthers the stability and orderly development of the law. A long-standing doctrine like that of physical presence offers the kind of stability and predictability that fosters interstate investment.

Economic presence invites years of litigation. The very fact that intangible property, such as the rights represented by a credit card, does not physically exist in the way that tangible property or persons exist is an invitation to endless litigation and chaos. Economic presence cannot be expected to have the same crisp, sharp edges as a concept as does physical presence, even after years of litigation. The uncertainty and cloud over the concept of economic nexus can only discourage certain types of interstate investment and thereby thwart the goals of the commerce clause.

4. Economic presence discriminates against the service sector, such as the issuers of credit cards

The physical presence nexus standard has helped maintain tax parity between the service and financial sector, and the manufacturing and mercantile sectors of the economy. The manufacturing and mercantile sectors have been the beneficiaries of a special federal nexus statute: Public Law 86-272. The physical presence nexus standard complements Public Law 86-272 in a very significant way that helps maintain a level playing field between the manufacturing and mercantile sectors and the service sector and financial sectors.

Specifically, Public Law 86-272 provides a federal nexus standard by preventing a state from taxing the income of a corporation whose only business activities within the state consist of the solicitation of orders for *tangible personal property*. Public Law 86-272 is limited to tangible personal property and does not extend to services, such as financial services. This limitation is presumably explained by two factors. First, the law was enacted in order to overrule *Northwestern Portland Cement*,[3] which upheld the imposition of a tax on the income of a purely interstate taxpayer selling tangible property – not services.

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[3] 358 U.S. 450 (1959).

Second, the law was adopted in 1959, at a time when the service and financial sectors was greatly overshadowed by the manufacturing and mercantile sectors. Further, the service sector tended to be intrastate in nature and not interstate. Accordingly, when Public Law 86-272 was adopted, Congress was focusing on the sale of tangible personal property and not on the relatively insignificant interstate service or financial sectors.

As interstate services grew in importance and significance and were deregulated, the physical presence rule allowed these sectors to achieve similar protection to that extended to the manufacturing and mercantile sectors under Public Law 86-272. Physical presence nexus is to the service and financial sectors what Public Law 86-272 is to the manufacturing and mercantile sectors.

The understanding and expectation of the service sector is that as long as they earn income in a state without having people or property in that state, no commerce clause nexus exists and no income tax can be imposed. The requirement of physical presence thus allows the financial and service sectors to achieve nearly the same treatment as those taxpayers that are protected by Public Law 86-272. Accordingly, the physical presence standard helps maintain competitive equity between taxpayers that provide services and those competitors that provide tangible personal property.

An economic presence rule would upset this balance and accommodation. Economic presence would exaggerate, rather than reduce, the competitive inequities of Public Law 86-272. The result would be to move away from a level playing field and discriminate against service providers, thus interfering unfairly and inequitably with the most rapidly growing sector in the U.S. economy.

5. Economic presence is more likely to lead to multiple taxation

As discussed above, intangible property has no corporeal form and does not physically exist. Consequently, unlike people or tangible property, intangible property cannot be physically located in any particular state through physical observation. Intangible property can be located in a state only through arbitrary rules that can vary from state to state. As illustrated above, the state of commercial domicile, the state of legal domicile, and the state of business situs might all seek to tax the royalties generated by a license agreement.

Consider a corporation that licenses the use of a trademark from L, the licensor. L is incorporated in State I and has its commercial domicile in State C. The corporation agrees to pay a royalty for every good it manufactures and sells bearing L's trademark. Assume the taxpayer manufactures the goods in State M, and sells the goods in State S.

Suppose that M considers the license to be located in the state of manufacture, that State S considers the license to be located in the state in which the goods are sold, that State C considers the license to be located at the licensor's commercial domicile, and that State I considers the license to be located at the licensor's state of incorporation. Under an economic presence standard, L – the licensor – would have nexus with States M, S, and C. The same royalty payment would be taxed by each of these states, resulting in multiple taxation.

6. Economic presence cannot be easily or fairly administered as a nexus standard

Economic nexus presents formidable administrative problems. An author receiving royalties from the sale of a book could be taxable in every state in which the book was sold. A television producer receiving royalties by a network for the use of a program could be taxable in every state in which the program was televised. An electronic data bank receiving payments for the use of its services could be taxable in every state in which its logo appeared on a computer screen. A start up company in Silicon Valley could be subject to tax in every state in which its software licensees operate. A bank purchasing mortgages could be subject to tax in every state in which the underlying mortgagors reside or in which the collateral were located. An athlete receiving royalties from the endorsement of a product could be taxable in every state in which the product was sold. A remote

vendor with modest sales in each of the fifty states would be required to file returns everywhere.

As these examples suggest, the compliance burdens for taxpayers and administrators would be immense under an economic presence rule. Small and medium sized businesses would be saddled with the obligation to comply with the tax laws of states with which they would have no familiarity. Administrative considerations alone suggest that economic presence is incompatible with the values and goals of the commerce clause.

III. CONCLUSION

By any principled measure of comparison, physical presence is to be preferred to economic presence as a nexus standard. Physical presence is more consistent with a bright line test, more consistent with settled expectations, more likely to reduce litigation and foster interstate investment, less likely to discriminate against the service sector, less likely to lead to multiple taxation, more easily administered, and more compatible with the growth of electronic commerce.

The states have little experience with administering an economic presence standard; the concept is amorphous and easily malleable. Economic presence is less a legal principle and more an invitation to chaos and multiple taxation.